NOTE

This Microfiche meets the quality requirements of the American National Standard for Microfiche of Documents (ANSI PH5.9-1975). However, because of imperfections in the document from which it was made, it contains images that are illegible or difficult to read. The source document for this microfiche is the best copy that could be obtained prior to filming.

Congressional Information Service, Inc
Washington, D.C.

CIS

SBA's FARM DISASTER LOAN PROGRAM

HEARINGS
BEFORE THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE
NINETY-SEVENTH CONGRESS
FIRST SESSION
ON
SBA'S FARM DISASTER LOAN PROGRAM

SEPTEMBER 9 AND 10, 1981

Printed for the use of the Committee on Small Business

U.S. GOVERNMENT PRINTING OFFICE
87-038 O WASHINGTON : 1981

S721-2

COMMITTEE ON SMALL BUSINESS

LOWELL WEICKER, Jr., Connecticut, *Chairman*

BOB PACKWOOD, Oregon
ORRIN G. HATCH, Utah
S. I. HAYAKAWA, California
RUDY BOSCHWITZ, Minnesota
SLADE GORTON, Washington
DON NICKLES, Oklahoma
WARREN RUDMAN, New Hampshire
ALFONSE M. D'AMATO, New York

SAM NUNN, Georgia
WALTER D. HUDDLESTON, Kentucky
DALE BUMPERS, Arkansas
JAMES R. SASSER, Tennessee
MAX BAUCUS, Montana
CARL LEVIN, Michigan
PAUL E. TSONGAS, Massachusetts
ALAN J. DIXON, Illinois

Robert J. Dotchin, *Staff Director*
R. Michael Haynes, *Chief Counsel*
Alan L. Chvotkin, *Minority Chief Counsel*

CONTENTS

Statement of Senator—

Weicker, Hon. Lowell, Jr., a U.S. Senator from the State of Connecticut, and chairman, Committee on Small Business ..... Page 1, 419

Testimony of—

Boucher, Paul, Inspector General, Small Business Administration 248

Davis, Thomas Earl, Blakely, Ga 410

Fahey, Thomas, certified public accountant, Alexandria, Va 368

Keeney, John, Deputy Assistant Attorney General, Criminal Division, Department of Justice, accompanied by James Graham, Deputy Chief, Fraud Section, Criminal Division; and Harriet J. McFaul, trial attorney, Fraud Section, Criminal Division 374

Segars, Ray V., Jr., Oswego, S.C 398

Statement of—

Cardenas, Hon. Michael, Administrator, Small Business Administration, accompanied by Charles R. Hertzberg, Director, Office of Business Loans; Earl L. Chambers, Director, Office of Portfolio Management; and Wiley S. Messick, Deputy Regional Administrator, region IV 451

Harper, Edwin L., Deputy Director. Office of Management and Budget 419

Jett, George W., General Counsel, Federal Emergency Management Agency, accompanied by Richard Sanderson, Director, Federal Response Coordination 437

HEARING DATES

September 9, 1981:

Morning session 1

September 10, 1981:

Morning session 419

SBA'S FARM DISASTER LOAN PROGRAM

WEDNESDAY, SEPTEMBER 9, 1981

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The committee met, pursuant to notice, at 9:30 a.m., in room 424, Russell Senate Office Building, Hon. Lowell Weicker, Jr., chairman of the committee, presiding.

Present: Senators Weicker, Gorton, Nickles, Rudman, Nunn, and Dixon.

Also present: Robert J. Dotchin, staff director; R. Michael Haynes, chief counsel; Alan L. Chvotkin, chief counsel, minority; Marc Smolonsky, investigator; John G. McLean, professional staff member; William P. Goodwin, Jr., special counsel, minority; and Margaret M. Broadbin, hearing clerk.

Senator WEICKER. The meeting of the Small Business Committee will come to order.

STATEMENT OF HON. LOWELL WEICKER, JR., A U.S. SENATOR FROM THE STATE OF CONNECTICUT, AND CHAIRMAN, COMMITTEE ON SMALL BUSINESS

Senator WEICKER. Today this committee begins hearings based on a 4-month staff investigation of the Small Business Administration's $3 billion farm disaster loan program. The results of this investigation clearly demonstrate that SBA has recklessly pumped out millions of dollars in farm disaster loans since 1977. This is a classic example of Government inefficiency, waste, and mismanagement.

Recently enacted legislation has asssured that SBA, for all intents and purposes, is out of farm disaster lending. Farmers, by law, must now go first to the Farmers Home Administration for help. This agency has the expertise to handle the farm disaster loans, not SBA.

Although these reforms were achieved, we must not lose sight of the fact that millions of taxpayers' dollars were improperly loaned. These funds, provided at interest rates of 3 percent or 6 percent, must be returned to the Treasury.

Through neglect, SBA has allowed this problem to fester. The SBA Inspector General's own audit reports were not taken seriously. It was not until this committee began its inquiry that any concrete action was initiated.

I will release today a variety of fact sheets prepared by committee staff and audits and investigations prepared by the SBA Inspector General which show farmers used money earmarked for crop replacement or debt repayment for such items as a refurbished home, investments in high-interest certificates of deposit, and other expenditures unrelated to disaster losses. The audits and investigations will also show that borrowers received illegal duplicate loans or Federal grants for identical losses.

The committee's findings are in no way a criticism of the American farm community as a whole. Rather, the hearing will demonstrate that a loosely run program which was intended to assist those who suffered very serious and very real losses due to extreme weather conditions was abused. Federal dollars were mishandled.

Before proceeding further, I would like to thank Senator Nunn, the ranking member of the committee, for his cooperation and assistance in this investigation and in putting these hearings together. He was instrumental in helping to achieve the legislative reforms I referred to earlier, and he remains steadfast in his desire to insure that taxpayers' dollars are properly spent.

At this point I would like to introduce these fact sheets and audits for the record.

[Material follows:]

FACT SHEET

BORROWER:	Thomas E. Davis Blakely, Georgia
SBA DISTRICT:	Atlanta
TYPE OF BUSINESS:	Farm. Peanuts and soybeans
AMOUNT OF SBA DISASTER LOAN:	$194,900
TERMS OF LOAN:	Maturity date is 15 years from date of loan at 3% interest per year
DISBURSEMENT DATE:	January 5 and February 11, 1978
TYPE OF DISASTER:	Drought

SBA LOAN HISTORY:

Thomas E. Davis applied to the SBA Atlanta District Office on September 7, 1977 for a disaster loan of $194,900 to relieve crop loss due to drought. The loan in that amount was approved on November 25, 1977. The loan was duly authorized and disbursed in separate checks on January 5, 1978 and February 11, 1978. Davis signed a certification of use of proceeds stipulating that the loan funds would be used exclusively for debt repayment and crop production expenses.

SBA INSPECTOR GENERAL FINDINGS

Davis received a $194,900 disaster loan from SBA while concealing a $321,000 emergency loan he received from FmHA for the identical loss. This is a violation of Title 42, U.S.C. Section 5155.

Davis used the same property as collateral for both loans.

Davis used $22,666.21 of the SBA loan proceeds to refurbish his home and make a small payment on a new boat. The refurbishment increased the value of his house by at least $34,000. He used another $90,000 of loan proceeds to purchase land, and deposited an additional $19,900 of loan proceeds into an interest-bearing bank account. His total misuse of SBA loan funds amounts to $132,566.21.

In addition, Davis has not made a single payment on his $194,900 SBA loan. The loan is seriously delinquent and the interest accrual is now $21,000 above his loan amount.

SBA ACTION

The case of Thomas E. Davis was referred to the Department of Justice, which declined prosecution.

The Atlanta District Office has taken no action to recover the loan in full or collect the delinquent payments, apparently due to the death of the loan officer servicing the Davis file.

BORROWER COMMENT

Davis commented that he has done nothing wrong, and cannot afford to repay SBA because he has suffered successive years of drought.

EXTERNAL AUDIT
of

THOMAS EARL DAVIS

BLAKELY, GEORGIA

DL-B-936,313 10 00 ATL

SMALL BUSINESS ADMINISTRATION
1953

EXTERNAL AUDIT DIVISION
OFFICE OF INSPECTOR GENERAL

JULY 1978

"FOR INTERNAL USE ONLY"

This external audit/~~investigation~~ was made in accordance with the policies and procedures contained in SOP 90 22 2. This report is issued by the External Audit Division, Office of Inspector General.

Approved:

Marvin P. Shelton

Marvin P. Shelton
Assistant Inspector General
for External Audit

Date 7/27/78

TABLE OF CONTENTS

Page

INTRODUCTION AND SCOPE 1

SUMMARY 2

BACKGROUND 3

LOAN INFORMATION 4

FINDINGS

Possible False Statements, Title 18 U.S.C. Section 1001 and Title 15 U.S.C. Section 645(a) 5

Unauthorized Use of Loan Proceeds - $132,566 10

8

REPORT ON EXTERNAL AUDIT

OF

THOMAS EARL DAVIS
BLAKELY, GEORGIA
DL-B-936,313 10 00 ATL

INTRODUCTION AND SCOPE

The Director, Atlanta, Georgia SBA District forwarded to the Office of Audits and Investigations for necessary action, a letter from the Farmers Home Administration (FmHA). Information contained in the letter, when compared with information in the SBA loan file, indicates that the borrower received duplicate benefits from, and provided duplicate collateral to, both agencies.

An audit was conducted to determine if the borrower did in fact receive disaster assistance from both agencies, and to verify the use made of the SBA loan proceeds.

Interviews were held with the borrower; the County Supervisor of FmHA; the Branch Manager of South Georgia Production Credit Association (PCA); and the President of The Peoples Bank, Blakely, Georgia. Pertinent records of the borrower; PCA; FmHA, and The Peoples Bank were reviewed.

SUMMARY

Thomas Earl Davis signed SBA Form 1050 Settlement Sheet, an Owner's Affidavit, and a Receipt and Certification of Use of Proceeds, all of which appear to be false statements.

A review of the borrower's records show that Davis used approximately $132,566 of the SBA loan proceeds for purposes not authorized.

BACKGROUND

According to the Application for Disaster Loan - Business, Thomas Earl Davis has been owner/operator of substantial farm acreage in Early County, Georgia, since 1967. The agribusiness produces corn, soybeans, peanuts, hogs and cattle.

A drought in the Summer of 1977 caused the operation to sustain a loss of approximately $195,000.

INTENTIONAL
BLANK

LOAN INFORMATION

Thomas Earl Davis applied for a disaster business loan of $194,929 to SBA on September 7, 1977, to relieve drought loss in his farming operation. A loan of $194,900 was approved on November 25, 1977, and the loan authorization provided for a fifteen-year repayment period with interest of three percent (3%) per annum, with annual payments of $16,327, beginning December 1, 1978. The loan proceeds were to be used approximately as follows:

*Southwest Georgia Production Credit Association (PCA)	$ 48,725
The Peoples Bank	48,725
Planting next year's crops	97,450
	$194,900 Total

Collateral included 472 acres of real estate in lots 184, 301, and 340 in the 26th and 28th Lard Districts of Early County, Georgia.

The loan was disbursed as follows:

January 5, 1978	
Thomas Earl Davis and Southwest Georgia Production Credit Association	$ 48,725
Thomas Earl Davis and The Peoples Bank	48,725
February 11, 1978	
Thomas Earl Davis	97,450
	$194,900 Total

* Correct title is South Georgia Production Credit Association.

FINDINGS

Possible False Statements- Title 18 U.S.C. Section 1001 and Title 15 U.S.C. Section 645(a)

Thomas Earl Davis signed SBA Form 1050, Settlement Sheet, an Owner's Affidavit, and a Receipt and Certification of Use of Proceeds, all of which appear to be false statements.

Title 18 U.S.C Section 1001 states in part that whoever in any manner within the jurisdication of any agency of the United States knowingly makes any false statements or makes or uses any false writing or document, knowing the same to contain any false entry, shall be fined, imprisoned, or both.

Title 15 U.S.C Section 645(a) states in part that whoever makes any statement knowing it to be false for the purpose of obtaining for himself an SBA loan, shall be punished by fine, or imprisonment, or both.

The Settlement Sheet signed by Davis on January 5, 1978 states in part that for the purposes of inducing SBA, directly or indirectly to participate in any way in this loan the Borrower, with knowledge of the provisions of 18 U.S.C. 1001 and 15 U.S.C. 645 which provide certain criminal penalties for making false statements, acknowledges receipt of $97,450 on January 5, 1978 and certifies (1) that the proceeds of this disbursement will be used, in accordance with the Loan Authorization, (2) that there has been no substantial adverse change in the financial condition since the application for this loan was filed, and (3) that there are no liens or encumbrances against the real or personal property securing said loan except those referred to and disclosed in the application for this loan.

The Settlement Sheet also contains the statement that whoever makes any statement knowing it to be false, or whoever willfully overvalues any security, for the purpose of obtaining for himself or for an applicant any loan, or extension thereof by renewal, deferment of action, or otherwise, or the acceptance, release, or substitution of security therefor, or for the purpose of influencing in any way the action of the SBA, or for the purpose of obtaining money, property, or anything of value, under the Small Business Act, as amended, shall be punished under the provisions of 18 U.S.C. 1001 and/or 15 U.S.C. 645, by fine of not more than $5,000 or by imprisonment for not more than two years, or both.

In the Owner's Affidavit sworn to and subscribed by Davis before a notary public on January 5, 1978, is a statement, in part, that the undersigned is the owner of all that tract or parcel of land lying and being in Early County, being more fully described in a security deed in favor of SBA dated the 5th day of January, 1978. Deponent further states that there are no unpaid or unsatisfied security deeds, mortgages, claims of lien against said land, except a first lien to Federal Land Bank, and a second lien to PCA.

The Receipt for and Certification of Use of Proceeds signed by Davis on January 5, 1978, states in part that he is aware that any person who knowingly makes a false statement or a misrepresentation by use of this certificate shall be subject to a fine of not more than $5,000 or to imprisonment for not more than two years or both, under provisions of the United States Criminal

Code (15 USC 645 and 18 USC 1001) and that Public Law 92-385 provides that on all disaster loans made after August 16, 1972, anyone who wrongfully misapplies the proceeds of a disaster loan shall be civilly liable to the Administrator in an amount equal to one and one-half times the original principal amount of the loan. Further, the undersigned with the same knowledge certifies that there has been no substantial adverse change in our financial condition since the application for this loan was filed, and that there are no liens or encumbrances against the real or personal property securing said loan except those referred to and disclosed in the application for this loan.

The external audit disclosed that the three above documents appear to be fraudulent. The Settlement Sheet shows that two U. S. Treasury checks in the amount of $48,725 each were issued for debt payment. One was issued to Davis and Southwest (sic) Georgia Production Credit Association (PCA), and the other to Davis and The Peoples Bank (Peoples), Colquitt, Georgia. Interviews with and records provided by Davis; the Branch Manager of PCA; and the President of Peoples disclosed the disposition made of the two checks. The check to Davis and PCA was endorsed by the PCA branch manager and returned to Davis. Davis then deposited this check, along with the one to Davis and Peoples, into a regular savings account in his own name at Peoples. The deposit of the two checks, totaling $97,450 was made on January 5, 1978.

The Settlement Sheet and the Receipt for and Certification of Use of Proceeds appear to be false in other respects. Both contain statements that the borrower certifies there has been no substantial adverse change in the financial condition of the borrower since the loan application was filed, and that there are no liens or encumbrances against the real or personal property securing such loan except those referred to and disclosed in the application for this loan. The Owner's Affidavit appears to be false because it contains the statement that there are no unpaid or unsatisfied security deeds, mortgages, or claims of lien against such land, except a first lien to Federal Land Bank, and second lien to PCA. The external audit disclosed information that indicates the aforementioned statements on the three documents are false.

Records reviewed at FmHA show that $330,000 from that agency was disbursed on January 4, 1978 by the escrow agent. The FmHA Itemized Account of Funds Received and Disbursed form shows $185,288.27 paid to South Georgia PCA to pay off notes and security deeds, and $47,400 to The Peoples Bank to pay off notes. The Branch Manager of PCA stated that Davis brought in two checks at the same time; he accepted the one for $185,288.27 to satisfy Davis' indebtedness to his firm, and gave Davis a receipt. He said that since he had no claim to the Davis-PCA joint-payee check in the amount of $48,725, he endorsed it, as Davis requested, and handed the check back to Davis. As previously mentioned, Davis deposited the check into a regular savings account. Similarly, the FmHA check to Peoples satisfied Davis' debt at that bank, and the Davis-Peoples joint-payee check in the amount of $48,725, not needed for debt payment, was also deposited into the regular savings account.

The cited documents that contain the certificate that there has been no substantial adverse change in the borrower's financial condition since the loan application appear to be false in this regard. The Application for

Disaster Loan - Business, signed by Davis on September 7, 1977, and the accompanying Personal Financial Statement signed September 6, 1977 both show his total liabilities, excluding mortgage debt, at $287,044. These liabilities were satisfied by disbursement of the FmHA loan prior to the disbursement of the SBA loan. However, since the FmHA amount disbursed amounted to $330,000, it appears the certificates of no adverse financial condition are false as his liabilities were increased $42,956.

The documents mentioned that contain the certificate that there are no liens or encumbrances against the real or personal property securing said loan except those referred to and disclosed in the application appear to be false in this regard. The loan application shows the following under notes, contracts and mortgages:

To Whom Payable	Balance	Security
South GA PCA	$197,845	land & equipment
Federal Land Bank	106,682	real estate
Peoples Bank	49,336	equipment
	$353,863	Total

As previously mentioned, the PCA debt was satisfied by the FmHA loan. However, FmHA took a lien on the land to secure a $330,000 debt prior to disbursement of the SBA loan. This created an additional encumbrance of approximately $102,000 on the land. Nothing was found to substantiate that this information was disclosed to SBA by Davis, nor the fact that he had received the FmHA loan.

Davis applied for the SBA loan on September 7, 1977, which was partially disbursed on January 5, 1978. He applied for the FmHA loan on October 29, 1977, and it was disbursed on January 4, 1978. The external audit disclosed that records show the same 472 acres of real estate was offered by Davis for both loans. This action did not affect the SBA numerical lien position, as documents submitted by Davis shows that SBA would be subordinate to PCA. He replaced PCA with FmHA. His actions did, however, decrease the value of the SBA lien, by the additional encumbrance to FmHA shown above.

Unauthorized Use of Loan Proceeds - $132,566

A review of the borrower's records show that Davis used approximately $132,566 of the SBA loan proceeds for purposes not authorized.

In accordance with the loan authorization, funds were disbursed as follows:

Disbursement Date	Amount	Purpose
1-5-78	$ 48,725	debt payment - PCA
1-5-78	48,725	debt payment - Peoples Bank
2-11-78	97,450	planting next year's crops
	$194,900	Total

On January 5, 1978, Davis deposited the two checks received on that date ($97,450) into a regular savings account, as shown on his deposit record. The savings account record shows a withdrawal of $90,000 on January 18, 1978. Records of The Peoples Bank show that Cashier's Check number 5594 was issued on that date, in the amount of $90,000, payable to L. L. Anglin. Davis said the money was used to purchase land, and he provided a copy of the warranty deed and title opinion for the land purchased.

On March 16, 1978, Davis deposited $77,450 of the $97,450 check he received on February 11, 1978, into the same savings account. The remaining $20,000 was deposited into his operating checking account. Subsequent to March 16, 1978, Davis withdrew a total of $65,000 from the savings account for deposit into the operating account, resulting in a balance in the savings account of $19,900.

A review of the uses made of the SBA loan proceeds drawn from the operating account shows $22,666.21 used for purposes not authorized as follows:

Date Paid	Amount	Payee	Purpose
4-11-78	$ 612.85	Day's Asphalt	new house
4-11-78	6,660.71	Seminole Bldg Supply	new house
4-17-78	135.97	Cumberland Capital	boat payment
4-17-78	1,375.00	Newberry Well Drilling	well - new house
4-18-78	80.00	Grady Holman	survey new land
4-24-78	400.00	Ulyses Albritton	new house
4-24-78	411.40	Ulyses Albritton	new house
4-24-78	250.00	Ulyses Albritton	new house
4-27-78	3,240.00	Eubank & Kelly	land clearing
5-1-78	1,400.00	Carlton Skipper	cabinets - house
5-3-78	3,176.40	Whatley Supply Co.	brick for house
5-12-78	4,787.91	Seminole Bldg Supply	new house
5-15-78	135.97	Cumberland Capital	boat payment
	$22,666.21	Total	

Recapitulation of loan proceeds used for purposes not authorized:

$ 22,666.21	above
90,000.00	land purchase
19,900.00	savings account balance
$132,566.21	Total

The purposes shown above regarding the expenditure of the $22,666.21 were explanations provided by Davis. Regarding the funds used for the new house, Davis stated that he was not building a new house, but remodeling one. The FmHA County Supervisor, who had earlier said it was a new house, confirmed that it was a remodeling job. He estimated the house to be worth $6,000 before the remodeling started, and will be worth between $40,000 and $60,000 when complete. He also stated that he had been told by others that his estimate of the value upon completion was too low.

One of the first statements made by Davis at the initial interview was that he guessed he was in trouble; would have to return the SBA money, but did not know how he could do it. He stated that, for a while, he kept the check for $97,450 that he received on February 11, 1978. He said he did not need it, and sent letters to SBA advising them of that fact, and requested disposition instructions. He stated that he received no reply from SBA. Davis said he did not keep copies of the letters. A second review of the docket file and a review of documents to be filed in the District Office was made; no letters mentioned by Davis could be found.

LIST OF EXHIBITS

1. Copy of Settlement Sheet.
2. Copy of Owner's Affidavit
3. Copy of Receipt and Certification of Use of Proceeds.
4. Copy of U.S. Treasury check to Davis and PCA ($48,725)
5. Copy of U. S. Treasury check to Davis and The Peoples Bank ($48,725)
6. Copy of U. S. Treasury check to Davis (97,450)
7. Copy of Davis' regular savings account record.
8. Copy of FmHA Itemized account of funds received and disbursed.
9. Memorandum of Interview, James H. Miller, PCA branch manager.
10. Copy of SBA Application for Disaster Loan with copy of personal financial statement.
11. Copy of FmHA Financing Statement and deed to secure debt.
12. Copy of Application for FHA Services.
13. Copy of Deed to Secure Debt - SBA loan.
14. Copy of Cashier's Check to L. L. Anglin ($90,000)
15. Copy of Warranty Deed and title opinion for land purchased from Anglin.
16. Copy of PCA receipt of $185,288.27 from Davis.
17. Copies of deposit tickets transferring funds from savings to checking account.
18. Schedule of cancelled checks.
19. Memorandum of Call to Edward D. Morton, FmHA.
20. Memorandum of Interview, Dan Minnix, President, The Peoples Bank.
21. Memorandum of Interview, Thomas Earl Davis, June 6, 1978.
22. Memorandum of Interview, Thomas Earl Davis, June 7, 1978.

A. Copy of letter from Atlanta District Director to Security and Investigations, with copy of County Supervisor's letter, FmHA.

B. Copy of memo from SBA loan officer to Chief, PMD.

C. Copy of Disaster Business Loan Authorization.

UNITED STATES DEPARTMENT OF AGRICULTURE
FARMERS HOME ADMINISTRATION
Blakely, GA 31723

SUBJECT: Thomas Earl Davis

May 4, 1978

TO: SBA
1720 Peachtree N.W.
6th Floor
Atlanta, GA 30309

Attention: Mr. Gary Renfroe

Dear Mr. Renfroe:

In accordance with our conversation on the phone today, we are sending to you herewith the information you requested on our loan to Thomas Earl Davis.

We have made the following loans to Mr. Davis ----

[illegible]

$221,000.00 on January 4, 1978 at 3% with a final due date of January 4, 1985. Loan secured by crops and chattels and a second lien on the following real estate-457 acres in Land Lots 184, 301, and 340 in the 26th and 28th Land District of Early County, Georgia. ✓

$100,000.00 on January 4, 1978 at 8% with a final due date of January 4, 1998. Loan secured by crops and chattels and a second lien on the following real estate-457 acres in Land Lots 184, 301, and 340 in the 26th and 28th Land District of Early County, Georgia. ✓

$97,000.00 on January 4, 1978 at 8% with a final due date of January 4, 1979. Loan secured by crops and chattels and a second lien on the following real estate-457 acres in Land Lots 184, 301, and 340 in the 26th and 28th Land District of Early County, Georgia.

$88,000.00 of the loan funds covered by the $97,000.00 note have been obligated but not ordered.

We have obligated a total of $418,000.00 in loan funds for Mr. Davis. Of this amount, $330,000.00 has been received.

Our appraised value of the Davis farm is $327,700.00. The Federal Land Bank has a lien that is prior to Farmers Home Administration for approximately $107,000.00.

If you need any other information, please advise.

Sincerely yours,

Edward D. Morton

Edward D. Morton
County Supervisor

EDM/czb

May 8, 1978

MEMORANDUM

To: Ralph W. Jernigan, District Chief, Portfolio Management Division

From: Gary H. Renfroe, Loan Assistant-327

Subject: Thomas Earl Davis

RE: (a) Edward D. Morton - FHA, Ltr dtd May 4, 1978
(b) SBA Loan Docket File
DL(B)936,313-10-00 ATL

1. Reference (a) outlines the loans made to Mr. Davis by FHA $321.000.00 was based on 1977 crop-year drought secured by 457 acres real estate in lots 184,301 and 340.

2. Reference (b) indicates SBA has loaned Mr. Davis $194,900.00 based on 1977 crop-year drought secured by 457 acres real estate in lots 184, 301 and 340.

3. The duplicated collateral above was valued by the Borrower at $236,500.00. Total loans now are as follows:

FHA $321,000.00 SBA $194,000.00
FLB/PCA $106,682.00
Total $621,628.00
Owners affidavid only shows FLB/PCA

4. In a telephone conversation of May 3, 1978, Mr. Morton indicated that FHA had no prior knowledge of Mr. Davis' SBA application.

5. Recommend that case be referred to S&I for proper action.

Very respectfully,

Gary H. Renfroe

5/15/78

U. S. SMALL BUSINESS ADMINISTRATION
Peachtree-25th Complex
1720 Peachtree Road, N.W., 6th Floor
Atlanta, Georgia 30309

Date: May 8, 1978

Reply to Attn of: Clarence B. Barnes, District Director

Subject: Thomas Earl Davis, Route 4, Blakely, Ga. 31723
DL(B) 936,313 10 00-ATL

To: Small Business Administration
Office of Audit and Investigations
1441 L. Street N.W.
Washington, D.C. 20416

This is a case that appears to have received duplicate benefits. Enclosed is a copy of a memorandum stating the details of the possible violation and a letter from Mr. Morton of FmHA giving the details of the loans they made to Mr. Davis.

Clarence B. Barnes
Clarence B. Barnes,
District Director

nrd
9/28/78
File

SEP 25 1978

Office of Inspector General/EA (78-67)

Thomas Earl Davis
Blakely, Georgia
DL-B-936,313 10 00 ATL

District Director
Atlanta, Georgia

On July 31, 1978, an external audit report on the subject company was forwarded to your office. The transmittal memorandum requested that the Inspector General be notified within 30 days of any action taken or contemplated to be taken as a result of the findings contained in the report.

This office has not received a response to the external audit report. The information requested is required by the Agency's Audit Committee in order to assure compliance with appropriate GAO and GSA guidelines as well as maintaining a proper oversight of the Agency.

A referral of the report to the Department of Justice, for consideration of possible criminal action, does not negate the need to take appropriate administrative action to safeguard the Government's interest and recover the maximum funds possible.

We would appreciate a response to the July 31, 1978, memorandum within 10 days.

Raymond F. Randolph
Raymond F. Randolph
Inspector General

APPROVED BY:

Marvin P. Shelton
Marvin P. Shelton, Asst. Inspector Gen.
for External Audit

EAD: MPShelton:mlb 9-25/78

(78-67)

10/13/78

File

U. S. SMALL BUSINESS ADMINISTRATION
Peachtree-25th Complex
1720 Peachtree Road, N.W., 6th Floor
Atlanta, Georgia 30309

October 3, 1978

Mr. Raymond F. Randolph
Inspector General
Small Business Administration
1441 L. Street
Washington, D.C. 20416

RE: Office of Inspector General
EA(78-67)

Dear Mr. Randolph:

This will acknowledge receipt of your letter of September 25, 1978, concerning an external audit report prepared for Farm Disaster Loan No. DLB-936,313 10 00-ATL., Thomas Earl Davis of Blakely, Georgia.

Due to the deliberate violations of the terms and conditions of the loan authorization by Mr. Davis, the loan was declared to be in default. The matter has been referred to the Department of Justice for civil action concerning collection of the debt due the United States. Furthermore, the United States Attorney for the Middle District of Georgia is reviewing the case for determination of any possible criminal liability.

If further information is desired, please advise.

Sincerely,

Fred Reed

Fred Reed, Acting
District Director

mps
1/22/79

January 17, 1979

S&I

Thomas Earl Davis
Blakely, Georgia

District Director
Atlanta, Georgia

The FBI has advised as follows regarding this case:

> Assistant United States Attorney, Edgar W. Ennis, Jr., Middle District of Georgia, Macon, Georgia, advised on January 9, 1979 that he is referring this matter to the Civil Division of the United States Attorney's Office at Macon, Georgia.

William W. Bowling, Director
Security and Investigations
Office of Inspector General

cc: Subject File
Reading File
External Audit File
External Audit Division

AO/OIG:S&I:VBHanrahan:plb
1/17/79

EXTERNAL AUDIT DIVISION
[illegible]
RECEIVED

June 23, 1980

Ms. Harriett McFaul
Department of Justice
Post Office Box 136
Ben Franklin Station
Washington, D. C. 20044

Dear Ms. McFaul:

Subject: Additional Investigation Concerning Thomas Earl Davis

As agreed during our meeting on June 13, 1980, I have completed additional investigation regarding this case. The following refers to the items suggested in the attached memorandum. (Attachment 1)

1. The SBA representative who was present when Davis signed the Owner's Affidavit and the Receipt and Certification of Use of Proceeds was James J. Long, Attorney, SBA.

   (Interview with Long, Attachment 2)

   Dennis Burns, the Disaster Attorney who signed the Settlement Sheet is no longer with the Agency.

2. The notary public on the Owner's Affidavit was James J. Long.

3. Interview (telephonic) with James Miller, PCA Branch Manager (Attachment 3).

4. Letters claimed by Davis to have been sent to SBA could not be located in SBA files. Files were searched twice during the initial investigation. The Chief, Finance Division, Atlanta District, was asked on June 16, 1980 for information regarding any other location of the letters. He offered no suggestions.

5. Attachment 1 memorandum mentions Richard Stearns as an SBA loan officer involved in this case. None of the documents in the file indicate that Stearns was involved. He stated on June 16, 1980 that he had never talked with Davis and was not involved in the Davis loan.

6. Status of loan repayment:

   First annual payment of $16,327 was due on December 1, 1978. Davis presented Check No. 2850, dated October 18, 1978, for this amount. The check was returned for insufficient funds. Davis was requested to replace the check on February 8, 1979. To date, the dishonored check has not been collected or replaced.

   Computer record shows that as of June 20, 1980, interest has been accrued for 556 days on the loan, further indicating that nothing has been paid on this loan, which is now two payments (approximately $32,654) past due.

   (above items, Attachment 4)

7. Mr. Edward D. Morton, County Supervisor, FmHA (now retired) was interviewed (telephonically) on June 20, 1980. (Attachment 5) Morton stated that Davis misrepresented the facts during their conversations.

A review of my notes and miscellaneous documents on hand was made on June 20, 1980. A memorandum to the FmHA permanent file, handwritten by Morton on April 25, 1978, was found. It appears, now, that this memo should have been included in the exhibits to my original report. Many of the topics in the memo were included in the original report, which may be the reason it was not used originally. A typed copy is provided, along with the photocopy made during the earlier investigation. (Attachment 6)

It would appear that additional Findings in this case would include:

> The issuance of a worthless check by Davis.
>
> Violation of 42 U.S.C. Section 5157 which provides a fine for misapplication of loan proceeds equal to one and one-half times the original principal amount of the loan.

Please call me for further assistance if needed.

Sincerely,

Paul L Hamilton
Paul L. Hamilton
Financial Investigator
FTS 257-2326

Enclosures

cc: ✓Marvin P. Shelton
Director, OFI

FACT SHEET

BORROWER:	R. V. Segars Oswego, South Carolina
SBA DISTRICT:	Columbia
TYPE OF BUSINESS:	Farm. Produces corn, cotton, soybeans and peanuts
AMOUNT OF SBA DISASTER LOAN:	$485,900
TERMS OF LOAN:	Maturity is 15 years from date of loan with interest of 3% on first $250,000 and 6 5/8% on remaining balance
DISBURSEMENT DATE:	April 11, 1978
TYPE OF DISASTER:	Drought

SBA LOAN HISTORY

R. V. Segars applied for a $485,900 disaster loan based on losses due to drought in 1977 on December 30, 1977. The SBA authorized a loan in this amount on March 11, 1978. Segars signed a certification of use of proceeds stipulating that the loan would be used exclusively for expenses related to crop production and debt repayment.

SBA INSPECTOR GENERAL FINDINGS

Segars received a $485,900 disaster loan from SBA and did not notify the agency of a $39,063.81 grant from the Agriculture Stabilization and Conservation Service for the identical loss. The loan authorization and agreement require the borrower to notify SBA if any funds are received from another federally funded agency. In addition, Title 42, U.S.C. Section 5155 prohibits duplication of Federal disaster assistance.

The borrower is required by the loan agreement to notify SBA if the actual loss due to the disaster is less than the estimated loss. SBA authorized a $485,900 loan to Segars based on his estimated loss of $485,871. The actual loss was only $412,042. Therefore, Segars received a loan which was $73,829 in excess of his actual loss. Segars failed to notify SBA of this excess so that his loan could be adjusted accordingly.

Page Two
Segars

The loan authorization and agreement stipulates that the loan proceeds may be used solely for debt repayment and for crop production. Segars used $55,117 of the funds targeted for crop production to purchase commodities futures.

Segars was deliquent on both his 1978 and 1979 annual payments and has failed to make his 1980 payment as of August 31, 1981.

SBA ACTION

The SBA District Office in Columbia demanded repayment of the excess loan payment, ASCS grant and the misued portion of the loan proceeds in October 1980. As of August 31, 1981 the borrower has not repaid any of these excesses.

BORROWER COMMENT

R. V. Segars admitted using $55,117 of the SBA loan to purchase commodities futures. However, he claimed that he did this every year and that it should be considered a normal operating expense.

Segars also acknowledged that he received a grant from the ASCS. He claimed, however, that he was not aware that this was improper and thus should not be required to repay SBA.

Segars disagreed with the IG's finding that he had an excess crop yield. He claimed this was SBA's responsibility as they required him to estimate his yield. Segars believed he should not be required to repay these excess funds in one lump sum, rather he should be permitted to continue to make annual payments and return the excess over the term of the loan.

SMALL BUSINESS ADMINISTRATION
Columbia, South Carolina

and

R.V. SEGARS COMPANY, INC.
Oswego, South Carolina

LOAN NUMBER FLDB-948-977-10-10-COLA
REPORT NUMBER 7(b)-80-04-64-253

R.H. RITCHEY
ONE HUNDRED SOUTH ROYAL STREET
ALEXANDRIA, VIRGINIA 22314
(703) 836-6701

16 July 1980

Director
Office of Regulatory Audits
Office of Inspector General
U.S. Small Business Administration
1441 L Street, N.W.; Room M-1
Washington, D.C. 20416

Dear Sir:

We have performed a limited-scope compliance audit in accordance with the terms and conditions of Contract Number SBA-1575-AUD-78 relating to the loan extended by the U.S. Small Business Administration (SBA), under the Section 7(b) Loan Program to R.V. Segars Company, Inc., Loan Number FDLB-948-977-10-10-COLA, in the amount of $485,900.

The extent of audit procedures required in performing this compliance audit is stated in the Scope of Audit section of this report.

This report is intended for use in connection with the contractual and regulatory provisions of the Loan Authorization and Loan Agreement to which it refers and should not be used for any other purpose, including association with the financial statements of R.V. Segars Company, Inc.

Very truly yours,

R.H. RITCHEY

By: Thomas K. Fahey
Thomas K. Fahey, CPA
Project Manager

TKF:mb

TABLE OF CONTENTS

Page

AUDIT SUMMARY 3

INTRODUCTION AND BACKGROUND 4

SCOPE OF AUDIT 5

RESULTS OF AUDIT 6

- Inadequate Books And Records 6
- Misuse Of Loan Proceeds 7
- Payments From Another Federal Agency Not Reported 7
- Excess Crop Yield Not Reported 8
- Delinquent Payments 9
- Financial Statements Not Submitted 10
- False Compensation Agreement 10
- Insurance Not Obtained 11

AUDIT SUMMARY

Our examination of the loan file of the SBA's Columbia District Office was completed on 16 July 1980. The results of that examination are as of that date. Our examination of the borrower's books and records was completed on 15 July 1980. The results of that examination are as of that date.

The findings disclosed by this audit are summarized below:

- The borrower does not maintain adequate books and records.
- The borrower used $55,117 of the loan proceeds required to be used for the 1978 crops to purchase commodity futures.
- The borrower did not notify the SBA of the $39,063.81 received from the Agricultural Stabilization and Conservation Service (ASCS) for the 1977 drought disaster.
- Although required by the Loan Authorization, the borrower did not report the actual 1977 crop yield of $286,541 which was $73,829 in excess of the estimated crop yield.
- The borrower was delinquent in making the $46,235 payment due 1 December 1978 and 1 December 1979.
- The borrower has not submitted financial statements as required.
- The Compensation Agreement executed by the borrower inaccurately stated $200 compensation was paid for services in connection with the SBA loan, when in fact $370 was paid by the borrower.
- It could not be determined that Federal flood insurance had been obtained as required.

The results of this audit were discussed as applicable with Mr. R.V. Segars, Jr., President of R.V. Segars Company, Inc. (borrower) and Mr. Robert Greenlee, Disaster Branch Manager of the SBA. Their comments are included in this report where appropriate.

INTRODUCTION AND BACKGROUND

In accordance with the terms of Contract Number SBA-1575-AUD-78 with the Small Business Administration (SBA), a compliance audit was made of the Authorization dated 11 March 1978 and Loan Agreement dated April 1978 which authorized a direct loan to R.V. Segars Company, Inc. in the amount of $485,900. The disaster under which this loan was authorized was a 1977 drought.

The borrower was established in 1955 and is engaged in the business of farming, ginning, and operating grain elevators. The business operates on a fiscal year ending 31 December and employs the cash basis of accounting. The sole owner is Mr. R.V. Segars, Jr.

The balance sheet for fiscal year 1976 discloses assets of $2,766,507, liabilities of $457,690, and owner's equity of $2,308,817. Estimates were used to value land and buildings in these statements.

The borrower also has received loans and payments from these Federal agencies:

Agency	Status of Loan	Purpose of Loan
SBA	Paid in full	Economic Injury Disaster Loan

Agency	Amount of Payments	Date of Payments	Purpose of Payments
Lee County ASCS	$29,635.80	1978	1977 Disaster
Sumter County ASCS	9,428.01	1973	1977 Disaster

SCOPE OF AUDIT

The scope of the compliance audit was limited to an examination of the books and records of R.V. Segars Company, Inc. and tests of the SBA loan files. The audit objective was to determine if R.V. Segars Company, Inc. had complied with applicable laws and regulations of the Section 7(b) Business Loan Program and the contract terms and conditions of the Loan Authorization and Loan Agreement.

The extent of audit procedures required in performing the compliance audit was guided by the General Accounting Office publication, Standards for Audit of Governmental Organizations, Programs, Activities and Functions and the generally accepted auditing standards promulgated by the American Institute of Certified Public Accountants. However, inasmuch as the standards just mentioned apply to full-scope audits, some of the standards are not applicable to a limited-scope compliance audit. Such standards were observed where applicable.

RESULTS OF AUDIT

Based upon our audit, we believe that R.V. Segars Company, Inc. has not complied with the requirements of the SBA Loan Authorization and Loan Agreement as stated in the following conditions:

Inadequate Books And Records

The borrower does not maintain adequate books and records as required.

Paragraph 3 of the Loan Agreement, SBA Form 153, requires the borrower to at all times keep proper books of account in a manner satisfactory to the SBA.

The borrower's books and records are not adequate because the source documentation used in preparing the financial statements submitted with the Loan Application were not available. Also, the borrower has not prepared financial statements since receiving the SBA loan.

Because the borrower's books and records were not adequate, we could not determine the following:

- accuracy of the financial statements submitted with the Loan Application
- whether the borrower had any additional liabilities which were not disclosed in the financial statements submitted with the application
- the borrower's equity in the collateral and the current status of the collateral pledged for the loan
- whether the borrower has violated the distribution and compensation restrictions contained in the Loan Agreement
- whether the borrower has incurred any other secured debt

Mr. Segars, Jr., borrower, stated the financial statements submitted with the Loan Application were prepared by a person who is no longer working for him. Further, he stated that the cash receipts and disbursements journal are the only records necessary for his business. Mr. Greenlee of the SBA had no comment.

Misuse Of Proceeds

The borrower used $55,117 of the loan proceeds required to be used for the 1978 crops to purchase commodity futures.

The Loan Authorization, Page 1. required the borrower to use $242,950 for debt payment and $242,950 for crop replacement or working capital.

The borrower used $242,950 for debt payment, $187,833 for crop replacement, and $55,117 was paid to Merrill Lynch for commodity futures. Further, the borrower signed a Receipt For And Certification of Use Of Proceeds, SBA Form 1161, on 11 April 1978 stating he would use $374,498 for working capital purposes.

Mr. Segars, Jr., borrower, stated that he used the $55,117 paid to Merrill Lynch for hedging purposes for the grain crop. Mr. Greenlee of the SBA had no comment.

Payments From Another Federal Agency Not Reported

The borrower did not notify the SBA of the $39,063.81 received from the Agricultural Stabilization and Conservation Service (ASCS) for the 1977 drought disaster.

Page 2 of the Loan Authorization required that prior to any disbursement of the SBA loan, the borrower notify the SBA of any and all financial assistance received from or applied for from any federally funded agency.

The borrower received $39,063.81 from ASCS, a federally funded agency, for the loss sustained on its 1977 crops. The estimated amount of the loss on these crops was the basis for determining the amount the borrower was eligible to borrow under the SBA disaster loan program. Had the borrower notified the SBA of the payments received from ASCS, the amount of the SBA loan may have been adjusted accordingly.

Mr. Segars, Jr., borrower, stated that he used the ASCS payments to pay off another debt. Mr. Greenlee of the SBA had no comment.

Excess Crop Yield Not Reported

Although required by the Loan Authorization, the borrower did not report the actual 1977 crop yield of $286,541 which was $73,829 in excess of the estimated crop yield.

Page 2 of the Loan Authorization required the borrower to notify the SBA if the total 1977 yield of each crop exceeded the estimated yield so that the SBA could adjust the amount of the loan accordingly.

The following is a comparison of the estimated and actual crop yields of the borrower for its 1977 crop:

	Corn	Soybeans	Cotton	Total
Estimated Income Prior to Disaster	$206,924	$132,265	$359,394	$698,583
Estimated Loss Due to Disaster	163,116	76,019	246,736	485,871
Estimated Income After the Disaster	43,808	56,246	112,658	212,712
Actual Income Per Borrower's Books	61,185	87,723	137,633	286,541
Actual Income Over Estimated Income	$ 17,377	$ 31,477	$ 24,975	$ 73,829

Thus the borrower's actual loss from the disaster was only $412,042 and not $485,871 as estimated.

Mr. Segars, Jr., borrower, stated that he did not realize he was required to report this to the SBA. Mr. Greenlee of the SBA had no comment.

Delinquent Payments

The borrower was delinquent in making the $46,235 payment due 1 December 1978 and 1 December 1979.

The Note, SBA Form 147, required the payment of annual installments of $46,235 commencing 1 December 1978.

The borrower made the 1 December 1978 payment on 22 October 1979 and made the 1 December 1979 interest payment on 5 July 1980. The principal portion of the 1 December 1979 installment was deferred until 15 August 1980.

Mr. Segars, Jr., borrower, stated that he paid the 1978 installment late and paid the interest on the 1979 installment and the principal was deferred until August 1980. Mr. Greenlee of the SBA had no comment.

Financial Statements Not Submitted

The borrower has not submitted financial statements as required.

The Loan Agreement, Paragraph 3, required the borrower to submit financial statements for the period ending 31 December 1978 and annually thereafter no later than two months following the expiration of any such period.

The borrower has not submitted financial statements for 31 December 1978 and 31 December 1979. The borrower has prepared tax returns for these years, but has not submitted these to the SBA.

Mr. Segars, Jr., borrower, had no comment. Mr. Greenlee of the SBA had no comment.

False Compensation Agreement

The Compensation Agreement executed by the borrower inaccurately stated $200 compensation was paid for services in connection with the SBA loan when in fact $370 was paid by the borrower.

The Compensation Agreement, SBA Form 159, is a certification by the borrower as to the amount of fees incurred in connection with the loan.

The Loan Application disclosed that the borrower had agreed to pay no one for assistance in filing this application. The borrower paid $370 for services in connection with the SBA loan. However, the Compensation Agreement stated that $200 was paid in connection with the SBA loan. Although the SBA had reviewed the Compensation Agreement, there was no evidence in SBA files that the discrepancy between the Compensation Agreement and the Loan Application had been investigated.

Mr. Segars, Jr., borrower, stated that the fee was reasonable for the services performed. Mr. Greenlee of the SBA had no comment.

Insurance Not Obtained

It could not be determined that Federal flood insurance had been obtained as required.

The Loan Authorization, Page 2, required the borrower to purchase Federal flood insurance if it was available.

The borrower could not furnish evidence that Federal flood insurance had been obtained and neither the borrower nor the SBA could provide documentation showing that such insurance was not available.

Mr. Segars, Jr., borrower, stated that his property was not in a flood zone. Mr. Greenlee of the SBA had no comment.

FACT SHEET

BORROWER:	Autauga Farming Company Autauga, Alabama
SBA DISTRICT:	Birmingham
TYPE OF BUSINESS:	Farm. Produces soybeans, cotton, wheat and hay
AMOUNT OF SBA DISASTER LOAN:	$345,000
TERMS OF LOAN:	Maturity is ten years from date of loan with annual interest rate of 3% on the first $250,000 and 6 5/8% on remaining balance
DISBURSEMENT DATE:	November 12, 1979
TYPE OF DISASTER:	Drought

SBA LOAN HISTORY

Autauga Farming Company applied for a $335,000 Disaster Loan on August 1, 1979. SBA found that the farm operation had a $334,961 crop loss due to drought conditions. A loan in the amount of $345,000 was approved and duly authorized by SBA on October 17, 1979. The loan proceeds were disbursed on November 12, 1979. Milton Wendland, President of Autauga Farming Company, signed a certification of use of proceeds stipulating that the funds would be used exclusively for crop production.

SBA INSPECTOR GENERAL FINDINGS

Autauga Farming Company received an SBA Disaster Loan based on a projected crop loss of $334,812. The loss was computed using figures which indicated a drop in crop volume per acre. However, because market prices on the crops increased dramatically by the time of sale, Autauga Farming Company actually had no income loss due to the drought of 1978. In fact, the operation's income for that year of $1,392,813 was $164,714 in excess of the farm's pre-disaster estimated income.

Thus, the borrower suffered no income loss and received an excess loan of $345,000.

SBA ACTION

No action taken. The SBA District Office in Birmingham disagrees with audit findings. The District contends that the excess crop yield was due to an increase in market prices, and that the borrower is entitled to the full amount of the loan proceeds.

BORROWER COMMENT

Borrower comment is identical to District Office comment.

SMALL BUSINESS ADMINISTRATION

Birmingham, Alabama

and

AUTAUGA FARMING COMPANY, INC.

Autauga, Alabama

LOAN NUMBER FDLB-921-142-10-05-BIR

REPORT NUMBER 7(b)-80-04-59-177

R.H. RITCHEY
ONE HUNDRED SOUTH ROYAL STREET
ALEXANDRIA VIRGINIA 22314
(703) 836-6701

3 June 1980

Director
Office of Regulatory Audits
Office of Inspector General
U.S. Small Business Administration
1441 L Street, N.W.; Room M-1
Washington, D.C. 20416

Dear Sir:

We have performed a limited-scope compliance audit in accordance with the terms and conditions of Contract Number SBA-1575-AUD-78 relating to the loan extended by the U.S. Small Business Administration (SBA), under the Section 7(b) Loan Program to Autauga Farming Company, Inc., Loan Number FDLB-921-142-10-05-BIR, in the amount of $345,000.

The extent of audit procedures required in performing this compliance audit is stated in the Scope of Audit section of this report.

This report is intended for use in connection with the contractual and regulatory provisions of the Loan Authorization and Loan Agreement to which it refers and should not be used for any other purpose, including association with the financial statements of Autauga Farming Company, Inc.

Very truly yours,

R. H. RITCHEY

By: Thomas K. Fahey
Thomas K. Fahey, CPA

TKF:lr

This is page 1 of 7 pages.

TABLE OF CONTENTS

Page

AUDIT SUMMARY 3

INTRODUCTION AND BACKGROUND 4

SCOPE OF AUDIT 5

RESULTS OF AUDIT 6

- SBA Loan Servicing Violations 6
- Excess Crop Yield Not Reported 6

AUDIT SUMMARY

Our examination of the loan file of the SBA's Birmingham District Office was completed on 6 June 1980. The results of that examination are as of that date. Our examination of the borrower's books and records was completed on 29 May 1980. The results of that examination are as of that date.

The findings disclosed by this audit are summarized below:

- The SBA did not service or process this loan in accordance with its Standard Operating Procedures.
- Although required by the Loan Authorization, the borrower did not report the 1978 crop yield of $1,392,813 which was $499,526 in excess of the estimated crop yield.

The results of this audit were discussed as applicable with Carolyn Young, CPA, representative of Autauga Farming Company, Inc. (borrower) and Henry H. Little, Disaster Branch Manager of the SBA. Their comments are included in this report where appropriate.

INTRODUCTION AND BACKGROUND

In accordance with the terms of Contract Number SBA-1575-AUD-78 with the Small Business Administration (SBA), a compliance audit was made of the Authorization dated 17 October 1979 and Loan Agreement dated 25 October 1979 which authorized a direct loan to Autauga Farming Company, Inc. in the amount of $345,000. The disaster under which this loan was authorized was a drought in 1978.

The borrower was established in 1964 and is engaged in the business of farming, row crops, and livestock. The business operates on a fiscal year ending 30 November and employs the cash basis of accounting. The sole owner is Milton Wendland.

The tax return for fiscal year 1979 disclosed assets of $1,013,959, liabilities of $1,066,113, capital of $27,237 and deficit earnings of $79,391. The annual sales were $2,428,097. Tax returns for the past three years indicated a $458,450 loss in 1979, a $9,881 profit in 1978 and a $203,286 loss in 1977.

The borrower also has received an ASCS disaster payment of $15,002.73 for low yields in 1978. This payment was disclosed to the SBA as required.

SCOPE OF AUDIT

The scope of the compliance audit was limited to an examination of the books and records of Autauga Farming Company, Inc. and tests of the SBA loan files. The audit objective was to determine if Autauga Farming Company, Inc. had complied with applicable laws and regulations of the Section 7(b) Business Loan Program and the contract terms and conditions of the Loan Authorization and Loan Agreement.

The extent of audit procedures required in performing the compliance audit was guided by the General Accounting Office publication, Standards for Audit of Governmental Organizations, Programs, Activities and Functions and the generally accepted auditing standards promulgated by the American Institute of Certified Public Accountants. However, inasmuch as the standards just mentioned apply to full-scope audits, some of the standards are not applicable to a limited-scope compliance audit. Such standards were observed where applicable.

RESULTS OF AUDIT

Based upon our audit, we believe that Autauga Farming Company, Inc. has not complied with the requirements of the SBA Loan Authorization and Loan Agreement as stated in the following conditions:

SBA Loan Servicing Violations

The SBA did not service or process this loan in accordance with its Standard Operating Procedures.

The Birmingham District Office failed to obtain the following as required:

- A Settlement Sheet, SBA Form 1050, was not obtained for the second loan disbursement as required by SOP 50-30.

Mr. Henry H. Little, SBA Disaster Branch Manager, commented that the Settlement Sheet should have been in the file.

Excess Crop Yield Not Reported

Although required by the Loan Authorization, the borrower did not report the actual 1978 crop yield of $1,392,813 which was $499,526 in excess of the estimated crop yield.

Paragraph 6a of the Loan Authorization required the borrower to notify the SBA if the total 1978 yield of each crop exceeded the estimated yield so that the SBA could adjust the amount of the loan accordingly.

The following is a comparison of the estimated and actual crop yields of the borrower for its 1978 crop:

	Hay	Soybeans	Cotton	Wheat	Total
Estimated Income Prior to Disaster	$315,586	$106,806	$795,203	$10,504	$1,228,09
Estimated Loss Due to Disaster	95,154	59,811	176,900	2,947	334,81
Estimated Income After the Disaster	220,432	46,995	618,303	7,554	893,2
Actual Income Per Borrower's Books	156,882	287,288	941,196	7,447	1,392,81
Actual Income Over or (Under) Estimated Income	$ (63,550)	$ 240,293	$ 322,893	$ (110)	$ 499,5

Thus the borrower's had no loss from the disaster and did not have a loss of $334,812 as estimated.

Mrs. Carolyn Young, representative of the Autauga Farming Company, Inc. commented that the crops were sold in 1979 when cotton was over $.50/lb. and soybeans were $7.50-$8.00/bu., accounting for the increase in income while production remained the same.

Mr. Henry H. Little, SBA Disaster Branch Manager, commented that we should use actual production figures instead of income figures to compute excess yield.

FACT SHEET

BORROWER:	F. W. Meyer Santa Barbara, California
SBA DISTRICT:	Los Angeles
TYPE OF BUSINESS:	Raising and marketing of agriculture products
AMOUNT OF SBA DISASTER LOAN:	$70,500
TERMS OF LOAN:	Maturity is 15 years from date of note with 3% annual interest.
DISBURSEMENT DATE:	January 17 and February 13, 1979
TYPE OF DISASTER:	Flooding

SBA LOAN HISTORY

On May 1, 1978, the Los Angeles District Office received a disaster loan application from F. W. Meyer for a claimed loss of $177,450. On June 14, 1978, Meyer submitted to SBA a loss computation report of an actual income loss of $65,961. An SBA loss verifier estimated Meyer's loss at $70,500, and a loan in that amount was approved by a processing loan officer on August 9, 1978. The loan was duly authorized on September 2, 1978, and disbursed in separate checks on January 17 and February 13, 1979. Meyer signed a certification of use of proceeds stipulating that the SBA loan would be used exclusively for expenses related to replacing 35 acres of gyposophila plants destroyed during the disaster.

SBA INSPECTOR GENERAL FINDINGS

Meyer received a $70,500 disaster loan from SBA while concealing a $100,000 loan he received from the Farmers Home Administration for the identical loss. Title 42, U.S.C. Section 5155 prohibits duplication of Federal disaster assistance.

While securing the respective loans, Meyer used the same property as collateral for each loan, without informing SBA or FmHA.

Moreover, Meyer certified to SBA that he would use that agency's loan proceeds to replace 35 acres of plants destroyed in the disaster when he knew these specific costs had been covered by the FmHA loan.

Meyer also used SBA loan proceeds to make payments to an affiliated business which he wholly owned and as a salary payment to himself, in violation of the SBA loan agreement which he signed.

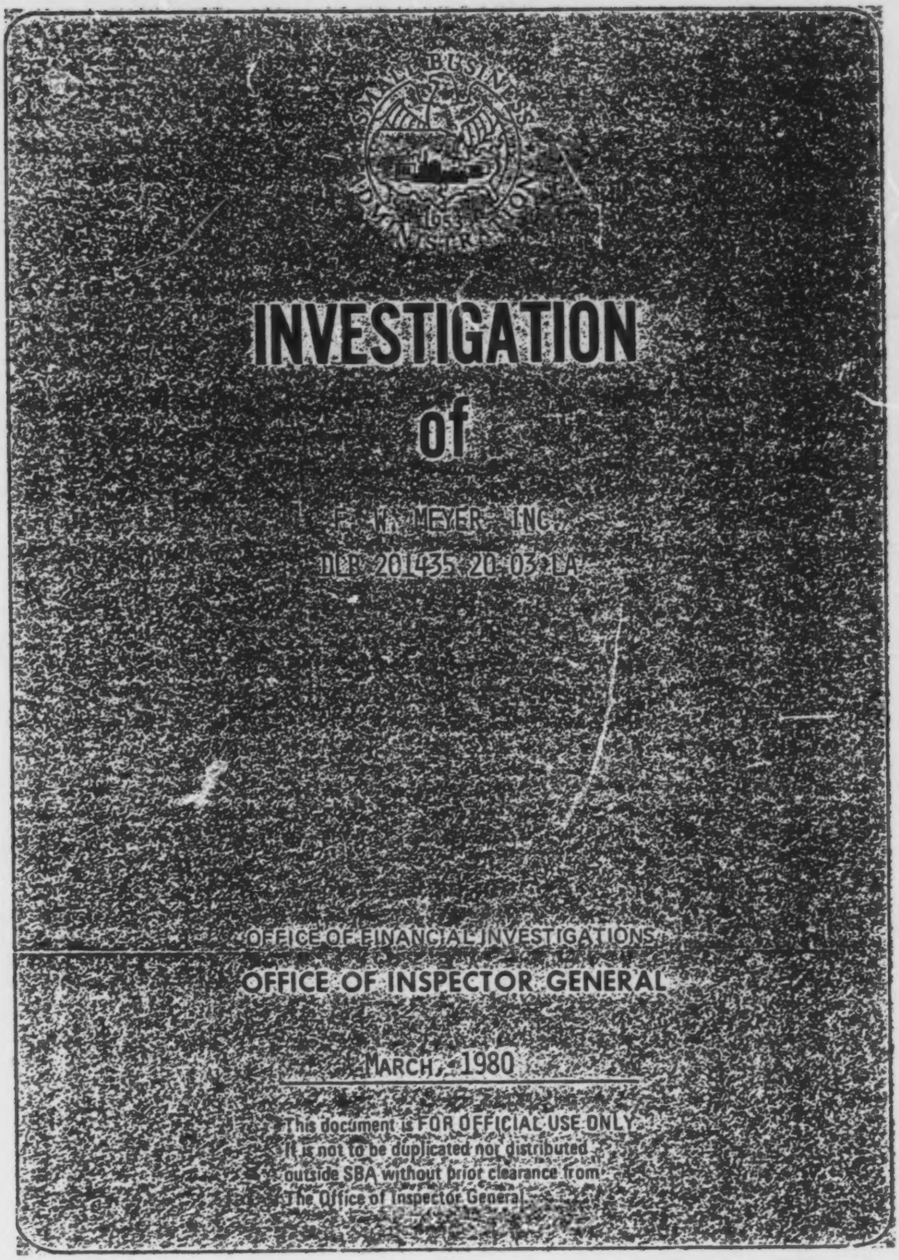
SBA ACTION

SBA referred the case of F. W. Meyer to the Department of Justice, which declined prosecution.

On June 3, 1980, the SBA Los Angeles District Office notified Meyer that the duplicate loan he received violated the terms of his note and agreement, and, thus, "this agency does hereby declare the entire balance of indebtedness in the amount of $67,580.64, plus accrued interest of $197.11 as of June 3, 1980, and with interest accruing thereafter at the rate of $5.63 per day, now due and payable. Meyer has met the normal loan payments, but has not paid the loan in full, as demanded by SBA.

BORROWER COMMENT

Meyer commented that his loss, according to his own estimate, was $170,000. He claimed that since the combined total of the SBA and FmHA loan does not exceed that figure, he had no duplication.



INVESTIGATION

of

F. W. MEYER, INC.

DLB 201435 20 03 LA

OFFICE OF FINANCIAL INVESTIGATIONS

OFFICE OF INSPECTOR GENERAL

MARCH, 1980

This document is FOR OFFICIAL USE ONLY
It is not to be duplicated nor distributed
outside SBA without prior clearance from
The Office of Inspector General.

ATTENTION

Action taken or to be taken on the information contained in this report must be reported to the OFFICE OF INSPECTOR GENERAL, Attention: Assistant Inspector General for Investigations, within 30 days of the issue of the report.

This investigation was made in accordance with the policies and procedures contained in SOP 90 22 2.

Information contained in this report is to be disclosed only to responsible SBA personnel on a "need to know" basis. Disclosure of information to other than SBA personnel must not be made without the approval of the Inspector General and may only be done in compliance with the Freedom of Information Act (5 U.S.C. 552), and the Privacy Act of 1974, where applicable, as implemented by Agency policy, regulations, and SOP's (40 03, 40 04) and 18 U.S.C. 1905.

This report is issued by the Office of Financial Investigations, OFFICE OF INSPECTOR GENERAL.

Approved:

Marvin P. Shelton

Marvin P. Shelton, Director,
Office of Financial Investigations

MAR 2 8 1980

Date ______________________

TABLE OF CONTENTS

Page

INTRODUCTION AND SCOPE 1

SUMMARY 2

RECOMMENDATION 2

BACKGROUND 3

LOAN INFORMATION 4

FINDINGS

Possible False Statement - Title 18, U.S.C. Section 1001 and Title 15, U.S.C. Section 645 (a) 7

Possible Violation of the Disaster Relief Act of 1974 - Title 42, U.S.C. Section 5155 and Title 42, U.S.C. Section 5157

Violation of Loan Agreement: $43,775 Paid To Borrower Personally And An Affiliated Concern

REPORT ON INVESTIGATION
OF
F. W. MEYER, INC.
DLB 201435 20 03 LA

INTRODUCTION AND SCOPE

An investigation was made of F. W. Meyer, Inc. by the Office of Financial Investigations, Office of the Inspector General, as part of its review of Disaster Loan Programs. This review was initiated as a joint project of the Department of Agriculture (USDA) and the Small Business Administration (SBA) for the purpose of identifying those disaster loan recipients receiving duplicate loan benefits from both SBA and the Farmers Home Administration (FmHA), and the causes for such duplication. In addition, the purpose of this investigation and review was to verify the uses made of the loan proceeds by a borrower, and to analyze and report on SBA program management compliance with certain internal operating procedures.

This investigation focused primarily on the period January 1978 through January 1980, as during this period the disaster loss occurred, the loans were applied for and disbursed, and the loan funds either committed or expended by the borrower. The SBA loan file was reviewed, as were the available records of FmHA and the borrower. SBA and FmHA officials, borrower principals, and other interested third parties were contacted to obtain pertinent documentation and interviewed as deemed necessary.

SUMMARY

Fred W. Meyer, President, F. W. Meyer, Inc. (Meyer Inc.) obtained a $70,500 Disaster Loan from SBA while apparently concealing the existence of a $100,000 Emergency Loan from FmHA for the identical disaster loss. Real property designated as collateral for the SBA loan was pledged by Mr. Meyer, apparently unknown to SBA, as security for the FmHA loan. Further, Mr. Meyer certified the SBA loan proceeds were used for the purchase of 96,500 plants, when he knew or should have known, that these same plants had already been paid for with monies drawn from the FmHA loan proceeds. In apparent violation of the SBA Loan Agreement, the borrower concern made payments of $33,775 to an affiliated concern and $10,000 to Mr. Meyer personally. Had SBA personnel known of the FmHA loan, SBA's Disaster Loan would not have been approved or disbursed.

RECOMMENDATION

It is recommended that SBA require the borrower to repay the SBA loan. SBA should also notify Farmers Home Administration of the action taken to avoid further duplication of efforts.

BACKGROUND

Meyer Inc. was formed and incorporated during November 1970. The specific business purpose of the corporation was to engage in raising and marketing agricultural products, specifically flowers. Since 1970, acreage under cultivation increased from 5 to 47 acres, most of which was leased. The concern reportedly ships flowers all 52 weeks of the year to selected wholesalers throughout the United States and Canada.

Frederick (Fred) W. Meyer was reportedly the concern's sole Officer, Director, and Stockholder. He was also apparently sole Owner, Officer, and Director of an affiliated firm, Mesa Verde Nursery Company, Inc.

At the time of Meyer Inc.'s disaster loss during February 1978, the concern was growing gypsophelia (baby's breath) plants on approximately 45 acres of leased land.

LOAN INFORMATION

Fred W. Meyer, President, and sole Owner of Meyer Inc., applied to FmHA for a Disaster or Emergency Loan on or about April 20, 1978. On May 1, 1978, SBA received from Mr. Meyer an Application For A Disaster Loan of $177,450 dated April 8,1978.

After verifying the damages, the SBA Loss Verifier estimated Meyer Inc.'s disaster loss at approximately $70,500. A Disaster Loan in this amount was recommended for approval by SBA's Processing Loan Officer on August 9, 1978.

On August 30, 1978, Fred W. Meyer executed a Certification of Disaster Loss for FmHA and an official of this Agency calculated the maximum amount of the concern's Emergency or Disaster Loss at $148,370.

Two days later on September 2, 1978, SBA authorized a $70,500 Disaster Loan for Meyer Inc. subject to the following pertinent condition:

> Borrower agrees to notify SBA of any funds received from any source, Government or private, which could be considered as reimbursement for losses suffered due to the disaster.

The loan proceeds were to be applied approximately as follows:

$70,500 To borrower to replace 35 acres of gypsophelia

Mr. Meyer was notified of loan approval on September 17, 1978, and subsequently advised, on October 21, 1978, that the initial loan disbursement check was available for pick-up at the SBA office.

FmHA disbursed a $100,000 Emergency or Disaster Loan, bearing 3% interest, to Meyer Inc. as follows:

Date	Gross Amount	Net Amount
October 11, 1978	$ 57,000	$56,398
February 12, 1979	43,000	43,000
	$100,000	$99,398

FmHA retained $602 of loan proceeds as payment for recording its lien on the real property securing the loan. The Agency received a $100,000 Third Trust Deed on October 11, 1978, on corporate real property located at 1405 Anderson Lane, Santa Barbara, California. Mr. Meyer reported that the estimated fair market value of this property was $180,000, subject only to prior liens totaling $31,000. Fred W. Meyer, President, Meyer Inc., executed a Promissory Note for $100,000 in favor of FmHA on November 28, 1978,

On January 7, 1979, Mr. Meyer executed a Loan Agreement containing the provision extracted from the Authorization relative to borrower notification to SBA of funds received as reimbursement for the disaster loss. The signed Loan Agreement also contained the following pertinent conditions:

1. Borrower agrees that in the event the authorized amount of the loan is in excess of the amount required to accomplish the purposes of the Loan as set forth in paragraph 5, of the loan Authorization for the loan, then at the direction of the SBA Disaster Branch Manager and in his sole discretion, the authorized amount of the loan will be reduced by an amount equal to such excess amount or such excess amount shall be applied on the installments of the principal owing on the Note in the inverse order of maturity.

2. Borrower agrees not to pay himself or any of his affiliates and/or subsidiaries any profit for work which they perform. Loan proceeds may be used only for reimbursement of labor and material costs.

Fred W. Meyer, as an individual, signed SBA Form 148, Guaranty, on January 17, 1979. Two days later, on January 19, 1979, he executed, as President and Secretary of Meyer Inc., a Note for $70,500 in favor of SBA.

SBA disbursed the loan proceeds to Meyer Inc. as follows:

Date	Amount
January 17, 1979	$ 5,000
February 13, 1979	5,500
February 13, 1979	5.000
February 13, 1979	5,000
February 13, 1979	10,000
February 13, 1979	10,000
February 13, 1979	30,000
Total	$70,500

SBA secured the loan with a Second Deed of Trust, perfected January 25, 1979, on corporate real property located at 5357 Anderson Lane, Santa Barbara, California. Mr. Meyer estimated the market value of this property at approximately $125,000 and reported only one prior lien of $36,000.

SBA and FmHA officials reported that Meyer Inc. was current on its loan payments.

FINDINGS

Possible False Statement - Title 18, U.S.C. Section 1001 and Title 15, U.S.C. Section 645(a)

Possible Violation of the Disaster Relief Act of 1974 - Title 42, U.S.C. Section 5155 and Title 42, U.S.C. Section 5157

Violation of Loan Agreement: $43,775 Paid To Borrower Personally And An Affiliated Concern

Fred W. Meyer, President, Meyer Inc., obtained a $70,500 Disaster Loan from SBA while apparently concealing the existence of a $100,000 Emergency Loan from FmHA for the identical disaster loss. Real property designated as collateral for the SBA loan was pledged by Mr. Meyer, apparently unknown to SBA, as security for the FmHA loan. Further, Mr. Meyer certified the SBA loan proceeds were used for the purchase of 96,500 plants, when he knew or should have known, that these same plants had already been paid for with monies drawn from the FmHA loan proceeds. In violation of the SBA Loan Agreement, the borrower concern made payments of $33,775 to an affiliated concern and $10,000 to Mr. Meyer personally. Had SBA personnel known of the FmHA loan, SBA's Disaster Loan would not have been approved or disbursed.

Title 18, U.S.C. Section 1001 and Title 15, U.S.C. Section 645(a) provide that whoever knowingly and willfully falsifies or conceals a material fact or makes a fictitious or fraudulent statement for the purpose of obtaining money or influencing in any way the action of the Administration shall be fined and/or imprisoned.

Title 42, U.S.C. Section 5155 provides that the President, in consultation with the heads of each Federal Agency, shall insure that no business concern receives disaster assistance with respect to any part of such loss as to which it has received financial assistance under any other program. Furthermore, whenever the President determines that the amount received by the business concern from all sources under this law exceeds the amount of the loss, he shall direct such business concern to reimburse the government for that part of the assistance deemed excessive.

Title 42, U.S.C. Section 5157(b) and (c) provide that whoever knowingly violates any order or regulation under this Act or knowingly misapplies the proceeds of a loan obtained under this Act shall be subject to a civil penalty and/or fine.

Fred W. Meyer, President, F. W. Meyer, Inc. applied for Emergency or Disaster Loans from both SBA and FmHA with applications dated April 8, 1978, and April 20, 1978, respectively. On the SBA application, Mr. Meyer reported the loss of 45 acres of gypsophelia plants as the result of flood damage occurring February 20, 1978. He requested a loan in the amount of $177,450 to replant 35 of these acres with gypsophelia, with the money specifically designated for plants, labor, and rent expense. On the FmHA application, Mr. Meyer also reported the loss of 45 acres of gypsophelia, but listed the date of the rain and flood damage as February 5, 1978. The FmHA Loan Application Form did not require Mr. Meyer to apply for a specific loan amount.

On June 14, 1978, Mr. Meyer submitted a Loss Computation to SBA reporting Meyer Inc.'s actual loss of income at $65,961. A SBA official verified the damages and on July 25, 1978, calculated Meyer Inc.'s disaster loss at $70,500. A loan for this latter amount was recommended for approval by SBA's Processing Loan Officer on August 9, 1978.

In accordance with a SBA request, on August 13, 1978, Mr. Meyer provided the Agency with a copy of a Corporation Grant Deed evidencing Meyer Inc.'s ownership of five acres of real property located at 1405 Anderson Lane, Santa Barbara, California. As shown in the Authorization, this five acre parcel was intended to provide collateral for the SBA loan.

Documentation showed that later during the month, on August 30, 1978, a Certification of Disaster Losses was executed by Mr. Meyer for FmHA. On the same date, an official of that Agency determined that Meyer Inc. was eligible for a $148,370 FmHA Emergency Loan.

Three days later, SBA authorized a $70,500 Disaster Loan, and on September 17, 1978, notified Mr. Meyer of the loan's approval. At this same time, Mr. Meyer was provided with a copy of the Authorization indicating the five acres would provide the collateral for this loan.

On October 11, 1978, Mr. Meyer executed a Deed of Trust in favor of FmHA pledging this same five acres at 1405 Anderson Lane as security for a $100,000 FmHA Emergency or Disaster Loan.

This Agency made its initial loan disbursement of $56,398 on this same date.

On October 21, 1978, Mr. Meyer was advised by SBA that his initial loan disbursement check was ready to be picked up. However, Mr. Meyer did not receive this check until approximately three months later on January 17, 1979.

SBA's records disclosed the disbursement was delayed by the collateral change. A December 7, 1978, SBA internal memorandum reported that Mr. Meyer requested the Agency accept beachfront property located at 5357 Anderson Lane, Santa Barbara, California, as substitute collateral for the previously designated five acres, as follows (partial):

> "Borrower requests substitution of collateral & offers attached as collateral because he says he'll be obtaining interim financing thru PCA (Production Credit Association) or Bk of America for operating capital & will pledge the 5 acres now designated as collateral. That loan will amt to abt $70,000 . . . ." (Emphasis Added).

The SBA official responsible for the memo containing this statement was interviewed and stated:

- That he was extremely fastidious and took accurate, careful notes.
- That if in his notes of December 7, 1978, he wrote PCA and the Bank of America, that was exactly what Mr. Meyer said.
- That he wrote his memos immediately following a conversation and was very careful to write exactly what was said.

-- That if Mr. Meyer had mentioned FmHA as the source of financing, he would have had to check further to insure Meyer Inc. did not receive duplicate disaster loan benefits.

-- That the memo was correct as written, and he believed that Mr. Meyer was seeking operating capital financing from either PCA or the Bank of America. (Emphasis Added)

-- That at the time of the conversation with Mr. Meyer, on or about December 7, 1978, he had no idea that Meyer had already pledged the five acres, tendered to SBA for collateral, as security for the FmHA loan. (Emphasis Added)

Fred W. Meyer was interviewed and questioned on January 17, 1980, regarding the substitution of collateral and stated:

-- That during late 1978, when he requested that SBA accept a Deed of Trust on the beachfront property at 5357 Anderson Lane as a substitute for this five acre parcel, the loan from FmHA was not discussed.

-- That he recalled informing an SBA official, possibly Bob Lamb, that the five acre parcel was needed as collateral in order to obtain another loan, but the source of such financing was not discussed.

-- That he did not recall mentioning PCA or any bank financing, but instead requested that SBA accept the beachfront property as collateral, as the five acres "already had too many people on the mortgage."

When questioned, the FmHA Loan Officer stated that Mr.Meyer indicated that he wanted to keep the beachfront property, originally offered to FmHA as collateral, free in order to obtain other financing. The FmHA Loan Officer further stated that the subject of a SBA Disaster Loan was not discussed with Mr. Meyer.

A review of SBA's loan file disclosed that at the time of the requested collateral change during December 1978, Mr. Meyer estimated the market value of the beachfront property at $125,000, subject to a prior lien of $32,000. Analysis indicates that if such were the condition, FmHA's $100,000 loan would not have been fully collateralized. Mr. Meyer estimated the value of the five acres at $180,000, subject to prior liens totaling $31,000, thus permitting the FmHA loan to be fully secured.

Fred W. Meyer was further questioned as to any possible justification for obtaining duplicate loan benefits and stated:

-- That since SBA loaned $70,500 and FmHA $100,000, and Meyer Inc.'s loss was $180,000, he did not feel guilty since he had not even recovered the total amount of the loss.

-- That he believed that FmHA would loan the entire amount of Meyer Inc.'s loss, but since he only received $100,000, he took what he could get which included the $70,500 loaned by SBA.

-- That since he did not know which agency might make the loan, he filed applications with both agencies.

-- That there was no mention of FmHA to SBA or vice versa during any of the loan negotiations, and no one from either agency asked if he had applied to the other agency, or if he received any funds from the other agency.

The SBA Authorization approved September 2, 1978, and the Loan Agreement executed by Mr. Meyer on January 17, 1979, approximately three months after the initial FmHA loan disbursement, contained the following funds reimbursement clause:

> "Borrower agrees to notify SBA of any funds received from any source, Government or private, which could be considered as reimbursement for losses suffered due to the disaster."

When interviewed regarding his understanding of this clause, Mr. Meyer stated:

- -- That SBA's Disaster Counsel, Bob Lamb, disbursed the loan funds and briefed him that the funds reimbursement clause in the Authorization and Loan Agreement applied to insurance reimbursements, and no mention was made of FmHA.

SBA's Disaster Counsel and loan disbursement officer was interviewed relative to the briefing provided Mr. Meyer on this clause and stated:

- -- That judging from the loan documents, he would have briefed Mr. Meyer at the time of loan closing on January 17, 1979, on the conditions contained in the Authorization and Loan Agreement.
- -- That although he could not recall Mr. Meyer, he briefed everyone in the same manner.
- -- That he briefed borrowers on the requirement to notify SBA of the receipt of funds from any source, Government or private, and specifically mentioned loans, grants, insurance, and any other Federally subsidized compensation. (Emphasis Added)
- -- That FmHA was not specifically mentioned during the briefing unless a borrower raised the question.

In interviews, three other SBA officials in the Burbank Disaster Office stated that the Burbank office interpreted the "funds reimbursement clause" to mean insurance or grant payments. However, SBA's Disaster Counsel and Meyer Inc. loan disbursement officer stated that his briefings were more thorough and comprehensive than many of SBA's less experienced personnel, as he had had experience in other disaster offices. Further, he stated that he did mention loans in connection with the "funds reimbursement clause."

The records of Meyer Inc. indicated the receipt and/or deposit of the $100,000 FmHA and $70,500 SBA loan proceeds to the appropriate corporate accounts as follows:

Agency Providing the Funds	Amount	Type of Account Deposited to & Number	Date of Deposit
FmHA	$ 56,398[1]	Savings-23-00-02448	October 11, 1978
SBA	5,000	Checking-090-013998	January 23, 1979
FmHA	43,000	Checking-090-013998	February 12,1979
SBA	65,000	Checking-090-013998	February 16,1979
	$169,898	Total	

The initial $56,398 FmHA loan disbursement was transferred from savings to checking during the period November 2, 1978 through December 15, 1978. Analysis of Meyer Inc.'s canceled checks showed the following apparently questionable payments cleared against the loan deposits:

	Date of Check	Check Number	Payee	Amount
A.	November 2, 1978	4754	Mesa Verde Nursery	$33,775
B.	December 1, 1978	4794	Fred W. Meyer	30,000
C.	February 12, 1979	4931	Santa Barbara Savings	40,000
D.	February 16, 1979	4796	Santa Barbara Savings	75,000

The check identified as "A" above, drawn partially from the proceeds of the FmHA loan deposit, paid a Mesa Verde Nursery Company, Inc. (Mesa Verde) Invoice Number 1090 dated November1,1978. for the purchase of 96,500 gypsophelia plants. A records review disclosed that Mr. Meyer had submitted this invoice to SBA as proof the SBA (not FmHA) loan proceeds were used as authorized.

---

[1] $602 of $57,000 disbursement retained by FmHA as payment for recording a lien on real property securing the loan.

In so doing, Mr. Meyer had executed on January 24, 1979, a Receipt for and Certification of Use of SBA Loan Proceeds which contained the following statement:

> "I am aware that any person who knowingly makes a false statement or a misrepresentation by use of this certificate shall be subject to a fine of not more than $5,000 or to imprisonment for not more than two years or both, under provisions of the United States Criminal Code (15 USC 645 and 18 USC 1001) and that Public Law 92-385 provides that on all disaster loans made after August 16, 1972, anyone who wrongfully misapplies the proceeds of a disaster loan shall be civilly liable to the Administrator in an amount equal to one and one-half times the original principal amount of the loan."

Further review of available documentation showed Mesa Verde to be an affiliate of Meyer Inc. and wholly owned by Mr. Meyer. A review of the SBA loan file revealed that the Agency was provided during loan processing with a tax return and financial statement disclosing such affiliation.

The Loan Agreement with SBA executed by Mr. Meyer on January 17, 1979, contained the following statement:

> "Borrower agrees not to pay himself or any of his affiliates and/or subsidiaries any profit for work which they perform. Loan proceeds may be used only for reimbursement of labor and material costs."

The Receipt for and Certification of Use of SBA Loan Proceeds executed by Mr. Meyer on January 24, 1979, showed an estimated labor expenditure of $28,670. Of this amount, the corporate books indicated $10,000, via check number 4793 on November 30,1978, was paid to Mr. Meyer as salary, an apparent violation of the Loan Agreement.

When interviewed on January 15 and 16, 1980, relative to the self-deal with Mesa Verde, Mr. Meyer stated:

-- That Meyer Inc. paid Mesa Verde the standard wholesale price for the plants, or at that time, $.35 per plant, which included a profit margin.

-- That Bob Lamb okayed this self-deal and informed him that the only consideration was that Meyer Inc. could not pay more than the standard rate to Mesa Verde.

-- That he did not know the cost to raise a gypsophelia plant from scratch, but since the growing of such plants required the rental of special equipment, the operation was only marginally profitable.

-- That he had no cost data broken down by the type of plants, as Mesa Verde produced plants of different varieties.

When questioned, the SBA official responsible for explaining the conditions found in the Loan Agreement to Mr. Meyer stated:

-- That a borrower was briefed that the purpose of the disaster loan was not to enable the borrower to earn a profit, but to provide loan funds to replace the loss.

-- That a borrower was briefed that compensation for the borrower's own time was not considered part of the loss.

-- That if Mr. Meyer had mentioned the self-deal with Mesa Verde, he would have questioned it.

-- That as Mr. Meyer did not pay Mesa Verde more than the going wholesale price for the gypsophelia, he saw nothing wrong with the purchase by Meyer Inc.

The check identified as "B" above, drawn partially from the proceeds or the FmHA loan deposit, was shown in Meyer Inc.'s Cash Disbursement Journal as a loan to Mr. Meyer. When questioned, Mr. Meyer stated:

-- That he received no salary from Meyer Inc., but drew personal monies as needed, which were recorded as loans to himself on the corporate books.

-- That during 1978, he was the lessee on both the Dos Pueblos and Bishop Ranch properties and in turn subleased these properties to Meyer Inc.

-- That as a consequence, the lease payments owed him by Meyer Inc. for the Dos Pueblos and Bishop Ranch properties were offset against his loans payable to Meyer Inc., $44,200 during 1978, and the balance $26,734.82, was recorded as his bonus.

-- That $10,000 was recorded on the Meyer Inc.'s books as salary as evidenced by Check No. 4793 for a net of $9,295, which with the $26,000 bonus, equated to a 1978 salary of approximately $36,000.

On January 17, 1980, the FmHA Loan Officer was contacted and stated the following relative to Mr. Meyer's use of the FmHA loan proceeds:

-- That FmHA did not really care what Mr. Meyer used the loan proceeds for, as the Agency was well secured and was certain to be repaid.

-- That Mr. Meyer was required to prepare a preliminary budget for the planned use of the loan proceeds, but this budget was used only as a guideline.

-- That as he recalled, Mr. Meyer's budget contained funds authorized for working capital, but whatever loan monies were not used to replace the disaster loss could be used for operations, per FmHA policy.

The checks identified as "C" and "D" above were transferred back and forth during the period February 12, 1979 through November 28, 1979, between the following accounts maintained by Meyer Inc.:

Account Number	Type of Account	Comment
23-00-02448	Savings	
23-263-40	Savings	$100,000 Six Month T-Bill
090-013998	Checking	
170-005-899	Checking	
23-697-46	Savings	$60,000 Six Month T-Bill

All funds were ultimately accounted for and appeared to have been applied in the ordinary course of business. As of January 16, 1980, the latter savings account, number 23-697-46, still had a balance of $60,000, drawn substantially from FmHA and SBA loan proceeds. From all indications, Mr. Meyer had pledged this T-Bill or 26 Week Money Market Certificate to PCA as security for a $27,780 operating loan for Meyer Inc.

A responsible SBA official stated that had the Agency known of the FmHA loan, the SBA loan could not have been approved or disbursed.

On January 30, 1980, an Assistant United States Attorney in Los Angeles, California, declined prosecution and recommended the case not be referred to the Department of Justice.

LIST OF EXHIBITS

The original exhibits are maintained in the files of the Office of Financial Investigations and Examinations, Office of the Inspector General:

1. Copy of SBA Form 5 (1-72), Application for Disaster Loan - Business, dated April 8, 1978.
2. Copy of FHA Form 410-1 (12-7-72), Application for FHA Services, dated April 20, 1978.
3. Copy of letter dated June 14, 1978, F. W. Meyer, Inc. to SBA, and attached SBA Form 1160 (10-77), Physical Crop Damage Report.
4. Copy of SBA Form 739A (8-75), Verification of Business Disaster Loss, dated July 25, 1978.
5. Copy of SBA Form 720 (8-67), Loan Officer's Report on Business Disaster Loan (Over $2500), dated August 9 and 18, 1978.
6. Copy of letter dated August 10, 1978, SBA to Fred W. Meyer.
7. Copy of letter dated August 13, 1978, F. W. Meyer, Inc. to SBA, and attached Corporation Grant Deed perfected August 25, 1975.
8. Copy of SBA Form 305 (2-72), Authorization, reviewed August 31, 1978.
9. Copy of FmHA Form 441-22 (9-17-75), Certification of Disaster Losses, dated August 30, 1978.
10. Copy of FmHA Form 441-26 (9-18-75), County Supervisor's Calculations and Verification of Qualifying Production Losses, dated August 30, 1978.
11. Copy of SBA Form 305 (2-72), Authorization, dated September 2, 1978.
12. Copy of letter dated September 17, 1978, SBA to F. W. Meyer, Inc.
13. Memoranda of Interview with Fred W. Meyer, Meyer Inc. President, dated January 17, 1980.

14. Memoranda of Interview with Fred W. Meyer, Meyer Inc. President, dated January 15, 1980.

15. Copy of letter dated October 21, 1978, SBA to F. W. Meyer, Inc.

16. Copy of SBA Attorney's Closing Check List - Home, for F. W. Meyer, Inc.

17. Copy of SBA Internal Memorandum on F. W. Meyer, Inc., dated December 7, 1978, and Individual Grant Deed executed between Peter J. Hovenier and J. Ann Hovenier, husband and wife (Grantors), and F. W. Meyer, Inc. (Grantee).

18. Copy of SBA Form 327 (6-76), Modification or Administrative Action, dated December 8, 1978.

19. Memoranda of Interview with SBA's Ex-Disaster Counsel, dated January 30, 1980.

20. Memoranda of Contact with FmHA's Disaster Loan Officer, dated January 17, 1980.

21. Copy of SBA Form 153 (8-71), Loan Agreement, dated January 17, 1979.

22. Memoranda of Interview with SBA's Acting Disaster Branch Manager, dated January 18, 1980.

23. Memoranda of Interview with a SBA Attorney, dated January 14, 1980.

24. Memoranda of Interview with SBA's Loan Officer, dated January 14, 1980.

25. Memoranda of Interview with Kent L. Englert, C.P.A., McGowan, Thompson, and Starlin, C.P.A.'s and Fred W. Meyer, President, Meyer Inc., dated January 16, 1980.

26. Copy of Meyer Inc. Savings Certificate Passbook, account number 23-00-02448, maintained at Santa Barbara Savings and Loan Association, issued February 24, 1976.

27. Copy of Meyer Inc. checking account bank statements, account number 90-013998, maintained at Crocker National Bank, dated November 1, 1978, through October 31, 1979.

28. Schedule of Bank Deposits recorded from the Meyer Inc. Payroll and Cash Disbursement Journal for the period October 1, 1978 through December 31, 1979.

29. Schedule of Questionable Checks recorded from the Meyer Inc. Payroll and Cash Disbursement Journal for the period October 1, 1978 through December 31, 1979.

30. Copy of Meyer Inc. canceled check number 4754 drawn to Mesa Verde Nursery for $33,775 on November 2, 1978, against Meyer Inc.'s checking account described as Exhibit 27.

31. Copy of Meyer Inc. canceled check numbers 4931 and 4976 drawn to Santa Barbara Savings for $40,000 and $75,000 on February 12 and 16, 1979, respectively, against Meyer Inc.'s checking account described as Exhibit 27.

32. Copy of Mesa Verde Nursery Co., Inc. invoice number 1090 to Meyer Inc. for $33,775, dated November 1, 1978.

33. Copy of letter dated January 24, 1979, Fred W. Meyer to SBA; copy of SBA Form 1161 (10-77), Receipt for and Certification of Use of Proceeds, dated January 24, 1979; and copy of miscellaneous invoices from various concerns to Meyer Inc., July 6, 1978 through December 7, 1978.

34. Copy of SBA Receipt Itemization Sheet executed by Fred W. Meyer on February 16, 1979.

35. Dun & Bradstreet, Inc. report on Mesa Verde Nursery Company, Inc. as of October 5, 1979.

36. Copy of Form 1040, U.S. Individual Income Tax Return - 1977, for Fred W. & Marlene MacElhenny Meyer, undated.

37. Copy of SBA Form 413 (8-67), Personal Financial Statement, dated April 1, 1978.

38. Memoranda of Interview with Fred W. Meyer, President, Meyer Inc., dated January 16, 1980.

39. Memoranda of Contact with George Mayeda, Owner, Mayman Flowers, dated January 16, 1980.

40. Copy of Meyer Inc. Loans Receivable and Payable to Shareholder,and Land Leases, dated December 31, 1978.

41. Copy of Meyer Inc. checking account bank statements,account number 170-005-899, maintained at Security Pacific National Bank, dated September 13, 1978 through December31,1978.

42. Copy of Meyer Inc. Savings Certificate Passbook, account number 23-263-40, maintained at Santa Barbara Savings and Loan Association, issued February 16, 1979.

43. Copy of Santa Barbara Savings letter dated January 16, 1980.

44. Copy of letter dated December 21, 1979, Ventura PCA to Meyer Inc., and Promissory Note for $27,780 executed by Frederick W. Meyer, Meyer Inc., in favor of the Ventura PCA, dated December 21, 1979.

45. Copy of Collateral Receipt number 6703, dated December 24, 1979.

46. Copy of December 31, 1978, Meyer Inc. Annual Financial Statements.

47. Memoranda of Interview with an AUSA, dated January 30, 1980.

LIST OF EXHIBITS

The original exhibits are maintained in the files of the Office of Financial Investigations and Examinations, Office of the Inspector General:

A. Letter dated August 10, 1979, USDA Regional Inspector General to SBA.

B. Copy of SBA Form 148(8-75), Guaranty, dated January 17, 1979.

C. Copy of SBA Form 147B(5-77), Note, dated January 19, 1979.

D. Copy of SBA Form 191(7-73), Request for Loan Check, dated September 30, 1978, and SBA Form 740(12-71), Certification and Receipt, dated January 17, 1979, and February 16, 1979.

E. Copy of Deed of Trust and Assignment of Rents, executed for $70,500 between F. W. Meyer, Inc., a California Corporation (Trustor) and SBA (Beneficiary), dated January 17, 1979.

F. Copy of Promissory Note, executed between Fred W. Meyer, President, F. W. Meyer, Inc. (Borrower) and FmHA, dated November 28, 1978.

M.108
4/21/80
File

MAR 31 1980

District Director
Los Angeles, California

Office of Inspector General/AIG/I (80-36)

F. W. Meyer, Inc.
Santa Barbara, California
DL-B-201,435-20-03-LA

Enclosed are two copies of the investigation report on the subject business. The exhibits supporting the information contained in the report are maintained in the Office of Financial Investigations.

The report indicates that Mr. Fred W. Meyer, possibly concealed the fact that he had also applied to Farmers Home Administration (FmHA) for a $100,000 Emergency Loan for the same disaster loss. In addition, collateral for the SBA loan was pledged to FmHA and $33,775 in payments were made to an affiliated concern.

These findings were discussed with a United States Attorney who refused prosecution for the lack of criminal intent and no known loss to SBA.

The investigation disclosed that Mr. Meyer was able to obtain duplicate payments from two government agencies (SBA & FmHA) for the same disaster loss due to the remissness on the part of SBA and FmHA personnel. There was a definite lack of cooperation between the personnel of both agencies. Although they were trying to aid the farmer in distress, no one apparently took the initiative to find out what the other agency might be doing or cared what was being done. By doing so, each agency appears to have violated the requirements of the Disaster Relief Act of 1974, by making duplicate loans which are in excess of the loss claimed by the farmer.

MAY 2 6 1980
FA2 -30- 2

The investigation also shows that none of the personnel from either agency took the time or the trouble to fully explain to the borrower that he could not obtain loans for the same loss from different agencies nor does it appear that he was asked if he had applied to any other agency for a loan. It also appears that SBA disaster personnel were not properly trained and even disagreed among themselves about the requirements of the Disaster Act.

We recommend that SBA take action to have the SBA loan repaid. SBA should also advise FmHA of the action to avoid another possibility of duplicate efforts.

Please advise this office within 30 days of the action taken on this report.

Should you have any questions or if this office can be of further assistance, please let me know.

R. R. Reusche
Assistant Inspector General
for Investigations

Enclosure

cc: James J. Graham
Deputy Chief
Fraud Section
Department of Justice
Washington, DC

CLEARED:

Marvin P. Shelton
Marvin P. Shelton, Director FI

FI:JBForeman:aj 3/28/80

Do [illegible] we have
a file on
this ?

H

U. S. SMALL BUSINESS ADMINISTRATION
350 SOUTH FIGUEROA
LOS ANGELES CALIFORNIA 90071

COPY

RECEIVED
APR 23 11 04 AM '80
OFFICE OF SECURITY
AND INVESTIGATIONS

Date: April 14, 1980

Reply to Attn. of: Kathryn M. Ritchie, Attorney

Subject: F. W. Meyer, Inc.
Santa Barbara, CA
DL-B-201 435 20 03 LA

To: Bernard Hayward
Chief, Portfolio Management Division

Attached is a letter from the Office of the Inspector General, dated March 31, 1980, addressed to the District Director, as well as a copy of the Investigation Report on the loan to subject firm referenced in said letter.

It is the recommendation of Office of Inspector General that LADO take action to have this SBA loan repaid since duplicate financing was received by the applicant under the Farmers Home Administration Emergency Loan program without the SBA's knowledge.

This matter is therefore referred to you to facilitate a demand for full repayment. If I can be of any assistance in this matter please contact me at x3082.

✓ cc: R. R. Reusche
Asst. Inspector General for Investigations

11 PS
6/2/80
File

CLEARED:

Marvin P. Shelton
Marvin P. Shelton, Director

OFI:JBForeman:tj 5/23/80

MAY 23 1980

District Director
Los Angeles, California

Office of Inspector General AIG/I (80-34)

F.W. Meyer, Inc.
Santa Barbara, California
DL-B-201,435-2003-LA

On March 31, 1980, we sent you copies of the investigation report on the subject borrower. Our transmittal memorandum requested that we be advised within 30 days of the action taken to recover duplicate crop loss funds from the subject.

As of this date, we have not received a reply.

This information is required under the Inspector General Act of 1978. We are required to report to Congress and to the Administrator on all actions taken or not taken on our reports. Therefore, a prompt reply will be appreciated.

R.R. Reusche
Assistant Inspector General
for Investigations

JUN 2 1980
FA2 - 30 - 4

S. SMALL BUSINESS ADMINISTRATION
LOS ANGELES DISTRICT OFFICE
350 SOUTH FIGUEROA
LOS ANGELES, CALIFORNIA 90071

CERTIFIED MAIL
RETURN RECEIPT REQUESTED June 3, 1980

Ms. Maureen Riley
County Supervisor
Farmers Home Administration
268 Halcyon Road
Arroyo Grande, California 93420

Re: F. W. Meyer, Inc.
SBA Loan No. 201435 20 03 LA

Dear Ms. Riley:

The Small Business Administration has learned that subject firm received a $100,000 emergency loan from your agency and that the purpose of this loan was to assist the borrower in repairing damages identical to the damages for which it received assistance from the SBA through the loan identified above.

This duplication of financial assistance resulted in violations of the terms of the Note and Loan Agreement which F. W. Meyer, Inc. executed as evidence of the indebtedness to the SBA. We have, therefore, made demand on that company for immediate full repayment of the loan pursuant to the terms of said note.

On June 3, 1980, I spoke with Katie Ewing, Clerk Typist in your office. I requested information on any and all loans which your agency has made to the identified firm. She indicated that your office processed Loan No. 0442952673463 for subject firm in November of 1978 and that the amount of the loan was $100,000.

The purpose of this letter is to inform FmHA of the action taken by this agency as a result of the violations noted above. If you have any questions regarding this matter, please do not hesitate to contact the undersigned at (FTS) 798-3082.

Sincerely,

Kathryn M. Ritchie
Attorney

U. S. SMALL BUSINESS ADMINISTRATION
LOS ANGELES DISTRICT OFFICE
350 SOUTH FIGUEROA
LOS ANGELES, CALIFORNIA 90071

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

June 3, 1980

Mr. Fred W. Meyer, President
F. W. Meyer, Inc.
1405 Anderson Lane
Santa Barbara, California 93111

Re: SBA Loan No. DLB 201435 20 03 LA

Dear Mr. Meyer:

The Small Business Administration has learned that your firm received a $100,000 emergency loan from the Farmers Home Administration during 1978 and that the purpose of this FmHA loan was to assist you in repairing damages identical to the damages for which you received assistance from the SBA through the loan identified above.

This duplication of financial assistance resulted in violations of the terms of the Note and Loan Agreement which you executed as evidence of your indebtedness to this agency. Copies of these documents are attached for your reference.

Because of this breach in the terms and conditions of said Note and said Loan Agreement, this agency does hereby declare the entire balance of indebtedness in the amount of $67,580.64 principal, plus accrued interest of $197.11 as of June 3, 1980 and with interest accruing thereafter at the rate of $5.63 per day, now due and payable.

Demand is hereby made upon you under the terms of said Note for payment of the entire balance due. If payment of said demand is not made on or before June 16, 1980, we shall feel justified in taking such legal and other action as we may deem necessary or appropriate to enforce collection of the debt.

Sincerely,

Bernard Hayward
Chief, Portfolio Management
Division

Attachments

U. S. SMALL BUSINESS ADMINISTRATION
350 SOUTH FIGUEROA
LOS ANGELES CALIFORNIA 90071

MPS
6/12/80

File

Date: June 3, 1980

Reply to
Attn. of: Kathryn M. Ritchie, Attorney, LADO

Subject: F. W. MEYER, INC.
SANTA BARBARA, CALIFORNIA
SBA LOAN NO. DLB 201 435 20 03 LA

To: R. R. REUSCHE
Assistant Inspector General for Investigations

This office is in receipt of your memo of March 31, 1980 referring the investigation report on subject firm to the District Director, Los Angeles District Office, for action.

Pursuant to the recommendations in your memo, LADO has taken the following actions:

1. Demand for immediate full repayment has been made upon subject firm (copy of demand letter attached).

2. Letter informing FmHA of this agency's action has been mailed to the FmHA office which processed the FmHA loan (copy attached).

If this office can be of any further assistance to you in this matter please contact the undersigned at (FTS) 798-3082.

Kathryn M. Ritchie
Kathryn M. Ritchie
Attorney

Attachments

R 6/17/80
JUN 17 1980
FA2 -30- 3

FI

R 6/10/80 (450)
569

FACT SHEET

BORROWER:	Harry M. Cook Talbotton, Georgia
SBA DISTRICT:	Atlanta
TYPE OF BUSINESS:	Farm. Produces corn, soybeans, peanuts and cattle
AMOUNT OF SBA DISASTER LOAN:	$91,200
TERMS OF LOAN:	Maturity date is ten years from date of loan with 3% annual interest
DISBURSEMENT DATE:	March 7, 1978
TYPE OF DISASTER:	Drought

SBA LOAN HISTORY

On August 13, 1977, the Atlanta District Office received a disaster loan application from Harry M. Cook for a claimed loss of $89,724. On October 8, 1977, SBA determined Cook's loss to be $91,200 based on 994 acres of estimated crop damage. On October 17, 1977, the loan was duly authorized, and disbursed in a single payment on March 7, 1978. Cook signed a certification of use of proceeds stipulating that the loan would be used exclusively for expenses related to crop production and debt repayment.

SBA INSPECTOR GENERAL FINDINGS

Cook received a $91,200 disaster loan from SBA while concealing a $100,000 emergency loan he received from the Farmers Home Administration for the identical loss. Title 42, U.S.C. Section 5155 prohibits duplication of Federal disaster assistance.

On March 14, 1978, Cook used more than $45,000 of the SBA loan proceeds to pay in full the mortgage on a newly constructed home, in violation of the loan agreement which he signed.

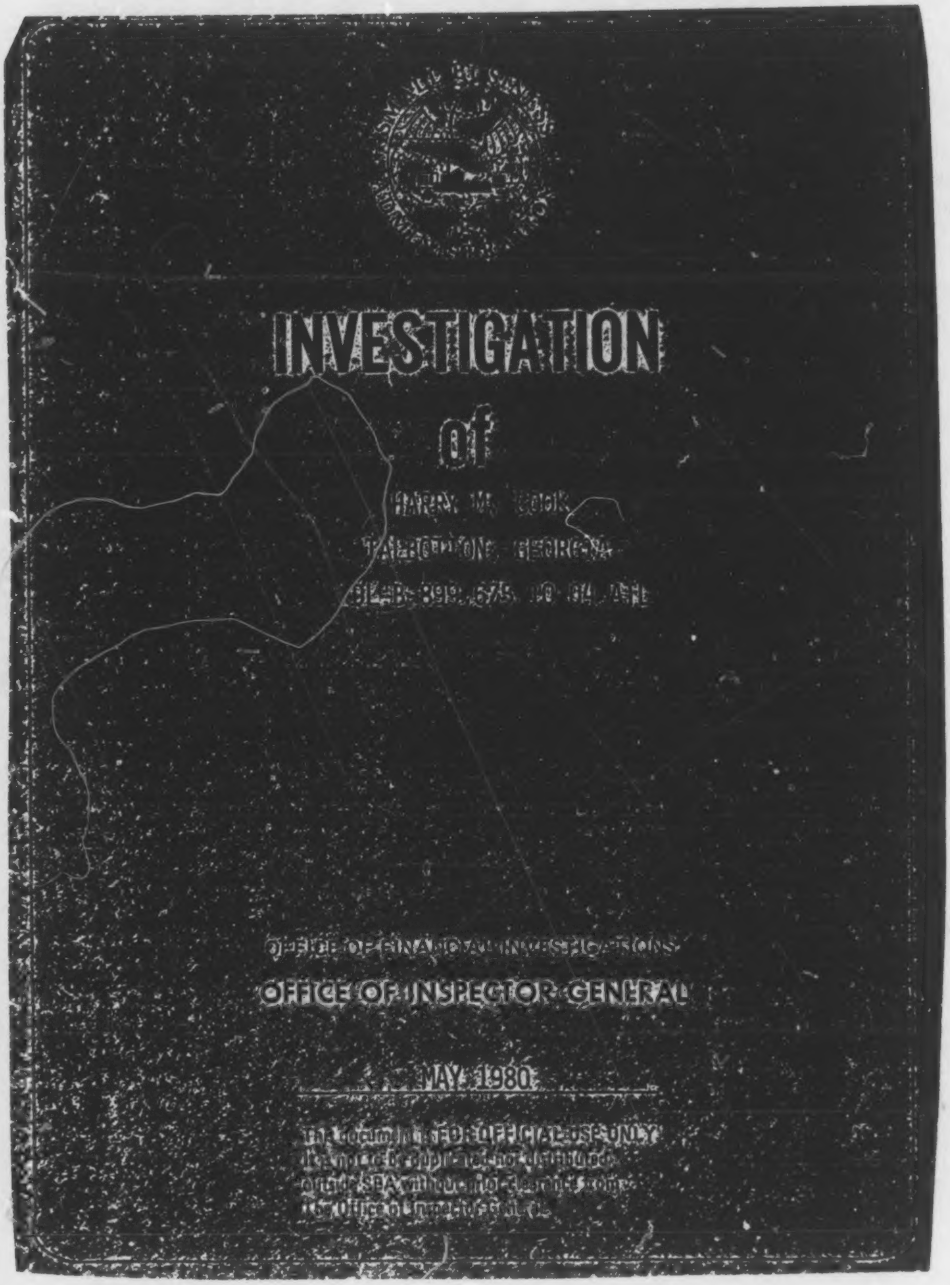
SBA ACTION

SBA referred the case of Harry M. Cook to the Department of Justice, which declined prosecution.

In 1980, the SBA Atlanta District Office notified Cook that the duplicate loan he received violated the terms of his note and agreement, and demanded immediate and full repayment. On July 13, 1981, Cook repaid his loan in full.

BORROWER COMMENT

Cook commented that he applied for the SBA loan because the FmHA loan approval process was too lengthy.



INVESTIGATION

of

HARRY M. COOK

TALBOTTON, GEORGIA

DL-B-899,675 10-04 ATL

OFFICE OF FINANCIAL INVESTIGATIONS

OFFICE OF INSPECTOR GENERAL

MAY 1980

This document is FOR OFFICIAL USE ONLY.
It is not to be duplicated nor distributed
outside SBA without prior clearance from
the Office of Inspector General.

ATTENTION

Action taken or to be taken on the information contained in this report must be reported to the OFFICE OF INSPECTOR GENERAL, Attention: Assistant Inspector General for Investigations, within 30 days of the issue of the report.

This investigation was made in accordance with the policies and procedures contained in SOP 90 22 3.

Information contained in this report is to be disclosed only to responsible SBA personnel on a "need to know" basis. Disclosure of information to other than SBA personnel must not be made without the approval of the Inspector General and may only be done in compliance with the Freedom of Information Act (5 U.S.C. 552), and the Privacy Act of 1974, where applicable, as implemented by Agency policy, regulations, and SOP's (40 03, 40 04) and 18 U.S.C. 1905.

This report is issued by the Office of Financial Investigations, OFFICE OF INSPECTOR GENERAL.

Approved:

Marvin P. Shelton

Marvin P. Shelton, Director,
Office of Financial Investigations

Date MAY 22 1980

TABLE OF CONTENTS

	Page
INTRODUCTION AND SCOPE	1
SUMMARY	2
RECOMMENDATION	2
BACKGROUND AND LOAN INFORMATION	3
FINDINGS	
Possible False Statements - Title 18 U.S.C. Section 1001 and Title 15, U.S.C. Section 645(a)	4
Possible Violation of the Disaster Relief Act of 1974 - Title 42, U.S.C. Section 5155 and 5157	4

REPORT ON INVESTIGATION
OF
HARRY M. COOK
DL-B-899,675 10 04 ATL
Talbotton, Georgia

INTRODUCTION AND SCOPE

An investigation was made of Harry M. Cook by the Office of Financial Investigations, Office of the Inspector General, as part of its review of Disaster Loan Programs. This review was initiated as a joint project by the Department of Agriculture (USDA) and the Small Business Administration (SBA) for the purpose of identifying those disaster loan recipients receiving loan benefits from both SBA and the Farmers Home Administration (FmHA) in excess of their eligibility. In addition, the purpose of this investigation and review was to verify the uses made of the loan proceeds by the borrower.

The SBA loan file was reviewed, as were the available records of FmHA and the borrower. SBA and FmHA officials, borrower principals, and other interested third parties were contacted to obtain pertinent documentation and reviewed as deemed necessary.

SUMMARY

Harry M. Cook obtained a $91,200 Disaster Loan from SBA while apparently concealing the existence of a $99,950 loan from FmHA for the identical disaster loss. Mr. Cook signed an SBA Settlement Sheet on which he certified that there had been no substantial adverse change in his financial condition since he applied for the SBA loan, even though he had received the FmHA loan during the interim period. Further, he certified that the proceeds of the SBA loan would be used in accordance with the Loan Authorization, even though he used $45,851 for a purpose not authorized. In the FmHA Promissory Note, Mr. Cook certified that he was unable to obtain this type of financing elsewhere, even though he had already applied to SBA. Had SBA personnel known of the FmHA loan, SBA's Disaster Loan would not have been disbursed.

RECOMMENDATION

It is recommended that SBA initiate action to recover the balance of the $91,200 loan from the borrower. This is considered duplicate loss benefits and in violation of the Disaster Relief Act of 1974, Title 42, U.S.C. Section 5155. Any action taken should be coordinated with the United States Attorney in Macon.

BACKGROUND AND LOAN INFORMATION

According to the SBA Loan Application, Harry M. Cook was 31 years of age at the time of application. His application for FHA Services shows four years of college completed. He received approximately 115 acres of land as a gift, and rents a substantial amount of additional acreage. In 1977, his acreage consisted of 794 planted in grain crops and 200 in pasture, for a total of 994 acres.

Cook established this agribusiness in 1971, and the operation produced corn, soybeans, peanuts, and cattle in 1977. During 1977, drought and worms caused physical crop losses to the business, estimated by Cook to be $89,724.

On August 13, 1977, Cook applied to SBA for a loan under SBA's disaster program, for $89,724 as relief for his physical crop loss. A loan in the amount of $91,200 was approved on October 17, 1977. Terms of the loan provided for a repayment ten years from date of note; interest at 3% per annum, and total annual payments of $10,691, beginning December 1, 1978. According to information provided by the District computer office, the loan is current.

Proceeds of the loan were received by the borrower on March 7, 1978.

FINDINGS

Possible False Statements - Title 18, U.S.C. Section 1001 and Title 15, U.S.C. Section 645(a)

Possible Violation of the Disaster Relief Act of 1974 - Title 42, U.S.C. Section 5155 and 5157

Harry M. Cook obtained a $91,200 Disaster Loan from SBA while apparently concealing the existence of a $99,950 loan from FmHA for the identical disaster loss. Mr. Cook signed an SBA Settlement Sheet on which he certified that there had been no substantial adverse change in his financial condition since he applied for the SBA loan, even though he had received the FmHA loan during the interim period. Further he certified that the proceeds of the SBA loan would be used in accordance with the Loan Authorization, even though he used $45,851 for a purpose not authorized. In the FmHA Promissory Note, Mr. Cook certified that he was unable to obtain this type of financing elsewhere, even though he had already applied to SBA. Had SBA personnel known of the FmHA loan, SBA's Disaster Loan would not have been disbursed.

Title 18, U.S.C. Section 1001 and Title 15, U.S.C. Section 645(a) provide that whoever knowingly and willfully falsifies or conceals a material fact or makes a fictitious or fraudulent statement for the purpose of obtaining money or influencing in any way the action of the Administration shall be fined or imprisoned or both.

Title 42 U.S.C. Section 5155 provides that each Federal agency administering any program providing financial assistance to persons suffering losses as the result of a major disaster, shall assure that no person receive such assistance with respect to any part of such loss as to which he has received financial assistance under any other program. Section 5157(a) of cited Code provides that any individual who fraudulently or willfully misstates any fact in connection with a request for assistance under this Act shall be fined or imprisoned or both for each violation. Section 5157(b) and (c) provide that whoever knowingly violates any order or regulations under this Act or knowingly misapplies the proceeds of a loan obtained under this Act shall be subject to a civil penalty and/or fine.

Cronology of events:

Cook applied to SBA for disaster loan	August 13, 1977
Cook applied to FmHA for disaster loan	September 30, 1977
SBA Disaster Loan Approved	October 17, 1977
$99,950 FmHA 3% Disaster Loan Received	November 1, 1977
Cook signed FmHA Promissory Note	November 1, 1977
$91,200 SBA 3% Disaster Loan Received	March 7, 1978
Cook Signed SBA Settlement Sheet	March 7, 1978

On September 30, 1977, FmHA determined the borrower's eligibility for crop disaster relief to be $99,950 for losses on 994 acres. On October 8, 1977, SBA determined Cook's eligibility on the same acreage to be $91,200 (rounded). The borrower received FmHA and SBA loans accordingly. Since SBA loaned the borrower $91,200 on the same crop acreage loss as did FmHA, the $91,200 is a duplication of the amount that he previously received from FmHA.

The receipt of duplicate benefits was discussed with Cook. He stated that:

-- The reason he applied to FmHA for a disaster loan after he applied to SBA was that it took SBA so long to get him the money.

-- He does not remember the names of SBA personnel he talked with, and does not recall any mention being made regarding loans from both agencies.

-- FmHA knew he had applied to SBA for a disaster loan.

It would appear that Cook's above statement as to why he applied to FmHA may not be reasonable, as only 47 days lapsed between applications. Also, the FmHA records show that on August 19, 1977, Cook informed an FmHA employee that he had applied to SBA for a disaster loan only because he was not aware of FmHA 3 percent loans.

A former and a present FmHA employee were interviewed separately during the investigation. Both expressed the belief that Cook knew all along that he could not have both loans. The present FmHA employee stated that when he found out that Cook had paid off the mortgage on his new house, he asked Cook where where he had obtained the money. He said Cook told him he got if from SBA. He said he told Cook that the SBA money would have to be paid back; to which Cook replied that he would cross that bridge when he came to it. However, he took no action to return the funds to SBA.

Cook used SBA loan proceeds to pay off the mortage on his new house on March 14, 1978, or approximately two years before this investigation began. He was authorized to use the SBA loan proceeds approximately as follows:

$26,000	to pay Peoples Bank of Talbatton
45,600	to plant next year's crops
19,600	for working capital
$91,200	TOTAL

A deposit slip in Cook's records shows that the $91,200, along with $30,000 from FmHA (not disaster funds) was deposited into account number 06 110 392, maintained at The Peoples Bank of Talbatton, on March 7, 1978. The account was overdrawn $3,784.21 at the time. On the same date, an unnumbered check was issued to that bank in the amount of $30,140.67. Cook's records show two notes, marked paid on March 7, 1978, for a total of $30,000.

Check number 2380 for $45,851.48 was paid from the account on March 14, 1978, and was issued by Cook to Home Federal Savings and Loan to pay of his new house. According to the SBA Check List dated August 16, 1977, the residence at that time was in the final construction stage, with first mortgage payment due September 1977.

Cook stated he does not remember any conversation with anyone at FmHA regarding the liquidation of the house mortgage.

All of the above findings were discussed with Cook, and he was told that he was being informed that they would probably be included in the report of investigation. His only response was that he acknowledged being informed.

This case was discussed with an Assistant United States Attorney in Macon, Georgia, on May 1, 1980. The Attorney stated he would accept the case for pre-trial diversion.

LIST OF EXHIBITS

1. Copy of Application for Disaster Loan - Business, dated August 13, 1977.
2. Copy of Application for FHA Services, dated September 30, 1977.
3. Copy of Disaster Business Loan Authorization, dated October 17, 1977.
4. Copy of Promissory Note, dated November 1, 1977.
5. Workpaper - Schedule of Cancelled Check - The Peoples Bank, Talbotton, Georgia, Account #06110392.
6. Copy of Settlement Sheet, dated March 7, 1978.
7. Copy of County Supervisor's Calculations and Verification of Qualifying Production Losses, dated September 30, 1977.
8. Copy of Physical Crop Damage Report, dated October 8, 1977.
9. Memorandum of Interview with Mr. & Mrs. Harry M. Cook, dated April 9, 1980.
10. Copy of FmHA Memorandum to File, August 19, 1977.
11. Memorandum of Telephone Call to Mr. Brent Stewart. Federal Crop Insurance Corporation, dated April 14, 1980.
12. Memorandum of Telephone Call to Mr. Jerry W. Cooper, FmHA County Supervisor, dated April 16, 1980.
13. Memorandum of Call to Harry M. Cook, dated April 25, 1980.
14. Memorandum of Interview with the Hon. Sam Wilson, Assistant United States Attorney, dated May 1, 1980.
15. Copy of Check List - Disaster Loans, dated August 16, 1977.

5/23/80
F.7e

CLEARED:

Marvin P. Shelton
Marvin P. Shelton, Director

MAY 22 1980

OFI:JHForeman:tj 5/22/80

District Director
Atlanta, Georgia

Office of Inspector General AIG/I (30-73)

Harry M. Cook
Talbotton, Georgia
DLB-899,657-1004-ATL

Enclosed are two copies of the investigation report on the subject. A set of exhibits supporting the information contained in the report is maintained in the Office of Financial Investigations.

The reports show that Mr. Cook received duplicate farm crop loss benefits from SBA and the Farmers Home Administration for the same crop loss. This is a violation of the Disaster Relief Act of 1974, Title 42, U.S.C. Section 5155.

It is recommended that action be initiated to recover the balance of the $91,200 received by the borrower from SBA which is in excess of his verified eligible loss and is considered a duplicate loss benefit. Any action taken should be coordinated with the United States Attorney in Macon.

A copy of the report has been set to the United States Attorney in Macon, for whatever action he deems appropriate.

Please advise this office within 30 days of the action taken on this report.

Should you have any questions or if this office can be of further assistance, please let me know.

For R.R. Reusche
Assistant Inspector General
for Investigations

Enclosures

MAY 29 1980

FA2 -62- 4

5/23/80
File

CLEARED:

Marvin P. Shelton
Marvin P. Shelton, Director

MAY 2 2 1980

OFI:JBForeman:tj 5/22/80

Honorable Denver L. Rampey, Jr.
United States Attorney
P.O. Box
Macon, Georgia 31202

Attention: Mr. Sam Wilson
Assistant U.S. Attorney

Re: Harry M. Cook
Talbotton, Georgia

Dear Mr. Rampey:

Enclosed is a copy of the investigation report on the subject. Also enclosed are the exhibits supporting the information contained in the report.

As discussed with Mr. Wilson, by a member of my staff, it appears that Mr. Cook may have violated Federal Statutes in obtaining duplicate farm disaster loan benefits from SBA and Farmers Home Administration.

Should you have any questions or if this office can be of further assistance, please let me know.

Sincerely,

For R.R. Reusche
Assistant Inspector General
for Investigations

Enclosure

MAY 2 9 1980

FA2 -62- 3

(I)

U. S. SMALL BUSINESS ADMINISTRATION
Peachtree-25th Complex
1720 Peachtree Road, N.W., 6th Floor
Atlanta, Georgia 30309

Date: July 3, 1980

Reply to Attn of: Clarence B. Barnes, District Director

O Subject: Harry M. Cook, Talbottom, Georgia FA2-62
DBL 899657 10 04 ATL

To: R. R. Reusche
Assistant Inspector General
for Investigations
Office of Inspector General
U. S. Small Business Administration
1441 L. Street, N. W.
Washington, D. C. 20416

Reference is made to the investigation report on the above concerning suplicate benefits received from SBA and FmHA. The recommendation is that SBA initiate action to recover the balance of $91,200. from the borrower, in coordination with the U. S. Attorney in Macon.

Demand is being made for recovery and if proper response is not received, we will meet with the U. S. Attorney and be guided by his recommendation on the necessary action to proceed further.

Clarence B. Barnes

Clarence B. Barnes
District Director

R 7/9/80
JUL - 9 1980
FA2 - 67 - 5

To FI - info

MJTS
8/11/80
File

AUG 8 1980

District Director
Atlanta, GA

Office of Inspector General AIG/I

Harry M. Cook
Talbotton, Georgia
DRL-899,657-1004-ATL

Thank you for your memorandum of July 3, 1980, informing this office that demand had been made upon the borrower to recover $91,200.

Please advise this office whether or not the demand was met and if not, what action your office has taken or plans to take.

Thank you for a prompt reply.

R. R. Reusche
Assistant Inspector General
for Investigations

CLEARED:

RWN
Richard W. Nicely, Acting Dir. FI

FI: BForeman;aj 8-7-80

DATE

FA2-62-6

[illegible]
8/27/8

U. S. SMALL BUSINESS ADMINISTRATION
Peachtree-25th Complex
1720 Peachtree Road, N.W., 6th Floor
Atlanta, Georgia 30309

Date: August 14, 1980

Reply to
Attn of: District Director

Subject: Harry M. Cook, Talbotton, Georgia FA2-62
DBL-899,657-10-04-ATL

To:

R. R. Reusche
Assistant Inspector General
for Investigations
U. S. Small Business Administration
1441 L. Street, N. W.
Washington, D. C. 20416

This is in answer to your memorandum of August 8, 1980, on the above.

After demand was made on Mr. Cook, he and his attorney visited this office for a full discussion of the situation. Upon returning home, Mr. Cook wrote us a letter asking for 30 days in which to attempt to make some arrangements for meeting our demand. The 30 days extension was granted and we anticipate some action being taken during the first week in September.

Clarence B. Barnes

Clarence B. Barnes
District Director

R 8/20/80
8/13/80
DATE
[illegible] - 62 - 7

10/31/80
File

OCT 31 1980

District Director
Atlanta, Georgia

Office of Inspector General AIG/I (FA2-62)

Harry M. Cook
Tilbottom, Georgia
DBL-339,637-1004-ATL

In your memorandum of August 14, 1980, you stated that the borrower was given a 30 day extension to meet the demand for recovery of $91,200.

Please advise this office on the current status of this loan.

/s/ Marvin P. Shelton

for R. R. Rausche
Assistant Inspector General
for Investigations

CLEARED:
Marvin P. Shelton
Marvin P. Shelton, Director

OFI:JForeman:tj 10/31/80

DATE

FA2-62 8

U. S. SMALL BUSINESS ADMINISTRATION
Peachtree-25th Complex
1720 Peachtree Road, N.W., 6th Floor
Atlanta, Georgia 30309

[illegible] 11-13-80

Date: November 10, 1980

Reply to Attn of: District Director

Subject: Harry M. Cook, Talbottom, Georgia FA2-62
DLB-889,657-1004-ATL

To: R. R. Reusche
Assistant Inspector General
for Investigations
SBA - Washington, D. C.

This is in response to your memorandum of October 31, 1980, on the above.

Demand was made for recovery of $91,200.00 from the above, which represented a duplicate benefit in which he received assistance from SBA and Farmers Home Administration. Representatives of this office have met with Mr. Cook and his attorney on several occasions and we have been unsuccessful in making collection of this duplication. Mr. Cook's loan is now current and has been current since its inception. Our legal staff advise that under the terms of the note, there is little else we can do at this point.

Should you have additional recommendations, please let us know.

Clarence B Barnes
Clarence B. Barnes
District Director

C 11/3/81
11/12/80
FA2-62-9

FACT SHEET

BORROWER:	Leonard M. Smith Muleshoe, Texas
SBA DISTRICT:	Lubbock
TYPE OF BUSINESS:	Farm. Produces corn, cotton, potatoes and bell peppers
AMOUNT OF SBA DISASTER LOAN:	$500,000
TERMS OF LOAN:	Maturity date is ten years from date of loan at 5% annual interest
DISBURSEMENT DATE:	February 15, 1980
TYPE OF DISASTER:	Hail

SBA LOAN HISTORY

On November 13, 1979, Leonard M. Smith applied to the Lubbock District Office for a $500,000 disaster loan, claiming damage to 495 acres of crops. The loan was approved and duly authorized on February 5, 1980. The loan proceeds were disbursed ten days later. On March 4, 1980, Smith signed a certification for use of proceeds stipulating that the funds would be used exclusively for debt repayment and crop production, with half of the loan amount provided for each category.

SBA INSPECTOR GENERAL FINDINGS

On March 3, 1980, Smith used the $250,000 earmarked for crop production expenses to purchase Federal Intermediate Credit Bank (FICB) bonds, with an interest rate of 15.35% per year and a maturity date of December 1, 1980. This transaction violated the terms of the loan agreement.

Smith used the bonds as collateral to obtain a loan of more than $441,350 from the Plainview Production Credit Association (PCA) at a variable rate of interest with all draws at least 12% per year.

As a result, Smith gained $2,041 in interest from the bonds, and the PCA gained the 12% interest on Smith's loan. The PCA loan would not have been necessary had Smith used the proceeds as indicated by the loan agreement.

SBA ACTION

The case of Leonard M. Smith was referred to the Department of Justice, which declined prosecution.

On August 14, 1980, the Lubbock District Office notified Smith that he had violated the terms and conditions of his loan agreement, and demanded immediate repayment in full of the loan.

Smith has a balance due of $437,258.89. His annual payments are $64,755. Under an informal agreement with the Lubbock District Office, Smith is making extra payments on the misused funds as his crop harvest allows. He paid $20,000 extra on January 15, 1981 and an additional $20,000 on March 25, 1981.

BORROWER COMMENT

Smith commented that he was pressured by the Production Credit Association to purchase the bonds and apply for the 12% loan.

0

INVESTIGATION
of

LEONARD M. SMITH
MULESHOE, TEXAS
FDLB-403,611,20,01-LUB

SMALL BUSINESS ADMINISTRATION
1953

OFFICE OF INSPECTOR GENERAL

OFFICE OF FINANCIAL INVESTIGATIONS
AND EXAMINATIONS

JUNE 1980

"For Internal Use Only"

INTENTIONAL
BLANK

ATTENTION

Action taken or to be taken on the information contained in this report must be reported to the OFFICE OF INSPECTOR GENERAL, Attention: Assistant Inspector General for Investigations, within 30 days of the issue of the report.

This investigation was made in accordance with the policies and procedures contained in SOP 90 22 3.

Information contained in this report is to be disclosed only to responsible SBA personnel on a "need to know" basis. Disclosure of information to other than SBA personnel must not be made without the approval of the Inspector General and may only be done in compliance with the Freedom of Information Act (5 U.S.C. 552), and the Privacy Act of 1974, where applicable, as implemented by Agency policy, regulations, and SOP's (40 03, 40 04) and 18 U.S.C. 1905.

This report is issued by the Office of Financial Investigations, OFFICE OF INSPECTOR GENERAL.

Approved:

Marvin P. Shelton
Marvin P. Shelton, Director,
Office of Financial Investigations

Date JUN 25 1980

TABLE OF CONTENTS

	PAGE
INTRODUCTION AND SCOPE	1
SUMMARY	2
RECOMMENDATION	2
BACKGROUND AND LOAN INFORMATION	3
FINDINGS	5

Possible False Statements, Misuse of Loan Proceeds, Mail Fraud, and Conspiracy to Defraud the United States, Title 15, U.S.C. Section 645(a), Title 18, U.S.C. Section 1001, Title 42, U.S.C. Section 5157, 317(a) & (c), Title 18, U.S.C. Section 1341, and Title 18, U.S.C. Section 371

REPORT ON INVESTIGATION
OF
LEONARD M. SMITH
ROUTE 1
MULESHOE, TEXAS
FDLB-403,611,20,01-LUB

INTRODUCTION AND SCOPE

The District Director, Lubbock, Texas, requested an investigation of a $500,000 Farm Disaster Loan made to Leonard M. Smith. The request, dated March 14, 1980, indicated that loan proceeds were not used as authorized.

The objectives of the investigation were to determine how loan proceeds were used and if any Federal Statutes were violated.

The investigation covered the period from October 31, 1979 to May 26, 1980. Borrowers bank statements, cancelled checks, receipts and invoices, and other records were reviewed.

SBA and Production Credit Association (PCA) file documents were reviewed. Interviews were made with Leonard M. Smith. Officials of SBA, Farmers Home Administration (FmHA), PCA, and others were interviewed.

Photocopies, memorandum and schedules were prepared to document findings.

SUMMARY

Leonard M. Smith made a possible false statement when he did not use the proceeds from an SBA Disaster Loan as authorized and certified too by Smith. Smith also possibly misused loan funds when he used proceeds of loan intended for crop production to purchase bonds. A possible use of the mails to defraud was committed when Smith used the U.S. mails to send a false receipt and certification for loan proceeds to SBA. Smith and an official of Plainview Production Credit Association possibly committed a conspiracy to defraud the United States when they conspired to wrongfully use SBA Disaster Loan proceeds to acquire Federal Intermediate Credit Bank bonds and make wrongful use of funds intended for crop production.

RECOMMENDATION

We recommend that SBA require the borrower to repay the loan immediately and that he be required to return the interest earned on the funds invested.

BACKGROUND AND LOAN INFORMATION

Leonard M. Smith began farming operations in 1959. In 1979 Smith farmed 1125 acres of owned land and 928 acres of leased land in the Lazbuddie Section of Parmer County near Muleshoe, Texas. Smith currently farms in the same area on 2205 acres of owned land and 928 acres of leased land.

Smith sustained hail damage of 1979 crops and applied for an SBA disaster loan for $500,000 on November 13, 1979. Claim was based on hail damage to 495.1 acres of corn, cotton, potatoes, bell peppers, carrots and cucumbers.

The disaster loan was approved, and proceeds of $500,000 were disbursed to Smith on February 15, 1980.

The SBA disaster loan to Smith provides for ten (10) annual installments of $64,755 commencing March 1, 1981. The loan is at five (5) percent per annum. No payments have been paid or due at the date of this report.

The SBA disaster loan was secured by a third lien on approximately 1118 acres of land, and the best available security interest on farm equipment.

SBA subordinated their lien position to Plainview Production Credit Association on March 14, 1980.

Smith applied for additional loan benefits on 1979 crops on April 9, 1980. The request was approved for $126,276 on April 29, 1980. Smith withdrew his request for additional benefits on May 14, 1980.

FINDINGS

Possible False Statements, Misuse of Loan Proceeds, Mail Fraud, and Conspiracy to Defraud The United States, Title 15, U.S.C. Section 645(a) Title 18, U.S.C. Section 1001, Title 42, U.S.C. Section 5157, 317(a) & (c), Title 18, U.S.C. Section 1341, and Title 18, U.S.C. Section 371

Leonard M. Smith made a possible false statement when he did not use the proceeds from an SBA Disaster Loan as authorized and certified too by Smith. Smith also possibly misused loan funds when he used proceeds of loan intended for crop production to purchase bonds. A possible use of the mails to defraud was committed when Smith used the U.S. mails to send a false receipt and certification for loan proceeds to SBA. Smith and an official of Plainview Production Credit Association possibly committed a conspiracy to defraud the United States when they conspired to wrongfully use SBA Disaster Loan proceeds to acquire Federal Intermediate Credit Bank bonds and make wrongful use of funds intended for crop production.

Title 15, U.S.C. Section 645(a) and Title 18, U.S.C. Section 1001 relate to false, fictitious, or fraudulent statements or misrepresentations made to any department or agency of the United States knowing same to be false, and provide criminal penalties.

Title 42, U.S.C. Section 5157, 317(a) relates to any individual who fraudulently or willfully misstates any fact in connection with a request for assistance under the Disaster Relief Act of 1974, and provides criminal penalties.

Title 42, U.S.C. Section 5157, 317(a) provides for fine of one and one-half times the original principal of a loan for anyone who knowingly misapplies the proceeds of a loan under the Disaster Relief Act of 1974.

Title 18, U.S.C. Section 1341 provides penalties for persons who obtain money by false or fraudulent pretenses and cause any such matter in furtherance of the scheme to be delivered by mail.

Title 18, U.S.C. Section 371 relates to two or more persons conspiring to defraud the United States or any agency of the United States, or interfering with or obstructing one of the government functions by deceit, craft, or trickery.

The SBA Loan Authorization for Smith's $500,000 disaster loan provided:

1. Approximately $250,000 for debt payment as follows:
   (a) Production Credit Association and Leonard Merrill Smith: approximately $250,000.

2. Approximately $250,000 for crop production expenses.

   Smith agreed to the provisions of this Authorization on February 5, 1980.

In the Receipt For and Certification of Use of Proceeds signed by Smith on March 4, 1980, Smith certified " . . . that the proceeds of this disbursement, on account of this loan, will be used or have been used for the new crops as set forth below."

Production Credit Association		$250,000
Crop Production Expenses as Itemized Below:		250,000
PCA Interest	$ 35,000	
Labor	32,880	
Repair & Supplies	25,000	
Fertilizers	30,000	
Chemicals & Insecticides	20,000	
Seed	10,000	
Fuel & Power	42,000	
Utilities & Nat. Gas	55,000	
Insurance	4,000	
Leases	11,000	
Real & Personal Taxes	4,500	
Living	24,000	
Total	$293,380	

Smith stated that the $250,000 allocated for crop production expenses was used to obtain a cashier's check. This cashier's check was used to purchase Federal Intermediate Credit Bank (FICB) bonds.

The FICB bonds in the amount of $250,000 were acquired March 3, 1980, with an interest of 15.35 percent per annum and mature December 1, 1980.

The FICB bonds are being used as part of the collateral on a Plainview Production Credit Association (PCA) loan to Smith for 1980 crop production.

PCA has committed a total of $441,354.93 for Smith's 1980 operating expenses and capital expenditures. Smith had drawn $207,742.31 against this loan at May 23, 1980. The loan is on a variable rate of interest with all draws to date at the rate of 12 percent per annum.

An analysis of Smith's checking account indicates the funds drawn from the PCA loan have been used substantially for Smith's farming operation and living expenses.

Smith signed the Receipt For and Certification of Loan Proceeds on March 4, 1980, and it was received by mail at the Lubbock, Texas office of SBA. At the time Smith signed and mailed this form, he had already used the proceeds of the loan intended for crop production to buy FICB bonds on March 3, 1980.

An SBA loan official has advised he would not have approved the loan had he known $250,000 of proceeds would be used to purchase bonds.

Smith, and a PCA official, possibly conspired to place funds, intended for crop production expenses, into FICB bonds for the mutual benefit of Smith and PCA. By this wrongful use of program funds they did thwart the intent of the Disaster Relief Act of 1974.

By use of SBA proceeds to obtain FICB bonds which were the used as partial collateral on a PCA loan, Smith gained $2,041 in interest income from February 5, 1980 to May 23, 1980.

PCA was able to reduce their risk on the loan to Smith. In addition, they gained the interest of twelve (12) percent per annum on the $250,000 which Smith would not have needed from PCA had he used SBA Disaster Loan proceeds as agreed. By having $250,000 placed in FICB bonds (the source of loan funds for PCA), PCA was provided with capital for making loans.

As Assistant United States Attorney for the Northern District of Texas has agreed to accept this matter for review and possible criminal or civil prosecution.

LIST OF EXHIBITS

The original exhibits are maintained in the files of the Office of Investigations & Examinations.

1. October 31, 1979, Financial Statement, Leonard M. Smith.
2. November 7. 1979, Schedule of Liabilities, Leonard M. Smith.
3. November 13, 1979, SBA Application Disaster Loan, Leonard M. Smith.
4. November 30, 1979, Physical Crop Damage Report, Leonard M. Smith.
5. November 30, 1979, SBA Loan Officers Report, Leonard M. Smith.
6. December 6, 1979, Letter S/L/S to Leonard M. Smith.
7. January 29, 1980, Deed of Trust, L.M. Smith & Wife to SBA.
8. Undated, Personal Property Offered as Security on Loan, L. M. Smith.
9. January 29, 1980, Security Agreement, L.M. & Jeanell Smith to SBA.
10. January 29, 1980, Promissory Note, L.M. & Jeanell Smith to SBA.
11. February 5, 1980, SBA Authorization & Loan Agreement, Leonard M. Smith.
12. February 5, 1980, UCC-1, L.M. Smith to SBA.
13. February 15, 1980, Letter, Disaster Branch Counsel to L.M. Smith.
14. February 15, 1980, Notification of Loan Closing, L.M. Smith.

15. February 19, 1980, Financial Statement, Security Agreement, and List of Equipment, L.M. Smith.

16. February 27, 1980, Plainview P.C.A. Loan Application, L.M. Smith.

17. March 3, 1980, Confirmation of Investment, Federal Intermediate Credit Bank of Houston to L.M. Smith.

18. March 4, 1980, Receipt & Certification Loan Proceeds, L.M. Smith.

19. March 6, 1980, Letter, J.M. Lackey, P.C.A., to SBA.

20. March 6, 1980, Request for Subordination, L.M. Smith.

21. March 12, 1980, Memo J.M. Lackey to SBA.

22. March 14, 1980, Subordination of Lien, SBA to P.C.A.

23. March 14, 1980, Letter, SBA A/D/D to OIG, Re: L.M. Smith, Request for Investigation.

24. April 7, 1980, Letter and Loss Computation, L.M. Smith.

25. April 29, 1980, Physical Crop Damage Report, L.M. Smith.

26. April 29, 1980, Loan Officers' Report on Reconservation, L.M. Smith.

27. May 14, 1980, Memo, Charlotte Hartwell, Re: Withdrawal of L.M. Smith Additional Loan Request.

28. May 26, 1980, Plainview P.C.A. Loan Status Report, L.M. Smith.

29. June 29, June 3, 1980, Interview, L.M. Smith.

30. June 3, 1980, Interview, Jeff Boone, FmHA.

31. June 3, 1980, Interview, Prentice Mills, ASCS.

32. June 3, 1980, Interview, J. M. Lackey, Plainview P.C.A.

33. June 3, 1980, Analysis L.M. Smith Checking Account at Security State Bank, Farwell, Texas.

34. June 4, 1980, Interview, Charles Jackson, SBA.

35. June 5, 1980, Interview, Creighton Carlin, SBA.

36. June 5, 1980, Interview, Paulina Jacobo, AUSA.

37. June 13, 1980, Telecon, J. Stinnett, SBA.

38. June 16, 1980, Analysis interest income to L.M. Smith by Purchase of Bonds.

MEMORANDUM OF PHONE CALL

Date: March 14, 1980
Subject: Farm Disaster Program Abuse
F/I: D. R. Holland

Charles Jackson, Disaster Loan Specialist, PMD, Lubbock, called about 8:00A. We spoke for about 15 minutes regarding a potential abuse of the program.

While processing a request for subordination from the Plainview, Texas Production Credit Association (PCA), Mr. Jackson had noted an apparent irregular use of loan proceeds. It seemed to him that the SBA loan had been used to buy debenture bonds from PCA. These bonds were then pledged to secure a 10 percent plus loan from PCA. For the farmer, the PCA loan had replaced the SBA loan. Mr. Jackson had concluded PCA was using its position with the farmer to get itself some cheap money. He felt there might be nine cases like the one he described involving the Plainview PCA.

Mr. Jackson was advised to put the particulars in a memo and send that memo to OIG through channels.

[illegible] 9 1980

FA2 -65- 2

U.S. SMALL BUSINESS ADMINISTRATION
712 FEDERAL OFFICE BUILDING & COURTHOUSE
1205 TEXAS AVENUE
LUBBOCK, TEXAS 79401
TELEPHONE 806-762-7502

4/11/80

March 14, 1980

Office of Inspector General
1441 L. Street N/W
Washington, D.C. 20416

RE: Leonard Merrell Smith
Rt. 1
Muleshoe, Texas 79347

RE: Plainview Production Credit Association
Box 669
Littlefield, Texas 79339

Loan Number: FDLB 403611 2001LUB
Amount Authorized: $500,000.00
Date Approved: 12-04-79
Amount & Date Disbursed: $500,000.00 02-15-80
Balance: $500,000.00
Amount Delinquent: None

MAY 29 1980
FA2 -65- 11

On March 7, 1980, the above named borrower brought a request for subordination and subordination agreement (Appendix 30) to the Lubbock District Office. The file was requested from the disaster office, so this action could be granted.

It was determined from the request and subordination agreement that the borrower had a renewal of $135,891.67. This appears to be an operating carryover, as it is carried thus on his financial statement. Therefore, we could not subordinate automatically under SOP 50-50 Para. 143 (2) (a). A call was made to Mr. James M. L[illegible]key, manager of the Littlefield office of Plainview Production Credit Association to explain that this request would have to be based on a case by case review. SOP 50-50 Para. 143 (2)(c) request for latest financial statement, latest appraisal figures and income and expense projections. On March 13, 1980, SBA received financial statement and appraisal. On financial statement dated February 19, 1980, under assets is listed SBA - invested in F.I.C.B. $250,000.00. On security agreement is the following: "Assignment on F.I.C.B. debentures". Borrower also shows $154,715.00 in farm products on hand (1979 crops not sold).

Loan authorization specifies use of proceeds as follows:

1. Approximately $250,000.-0 for debt repayment as follows: Production Credit Association and Leonard Merrell Smith, approx. $250,000.00.

2. Approximately $250,000.00 for crop production expenses.

SBA form 1161 "Receipt for and Certification of Use of Proceeds" reflects $293,380.00 used for authorized crop production expenses. This money would have had to have been used between February 15, 1980 and March 4, 1980 and cannot be anticipated expenses because financial statement dated February 19, 1980 shows only $6,000.00 in cash, therefore, it appears $250,000.00 was aplied on PCA debt and $250,000.00 was used to purchase F.I.C.B. debentures as they are not reflected on financial statement dated October 31, 1979.

If these funds had been used as authorized, there would have been no carryover operating debt, and an automatic subordination would have been in order. It will still be necessary to subordinate for borrower to secure 1980 operating money.

This appears to be a flagrant irregularity. We have been concerned and suspicious that this has been going on for some time. This appears to be standard operating procedure with Plainview PCA.

This appears to be a way to get cheap government money and convert it to debentures at 10 to 11 per cent and loan back to the farmer at 14 to 15 per cent. Not only is this a misuse of funds, but tends to place other lenders, who are trying to live by the guidelines, at an unfair disadvantage.

Admittedly, other lending institutions are possilby doing the same thing. This is the first instance, where we feel that we have sufficient information to warrant reporting.

Sincerely,

C. H. Jackson

Charles H. Jackson
Disaster Loan Specialist

CHJ:tr

CONCURRENCE:

Curtis G. Olson

Curtis G. Olson
Acting District Director
Lubbock District Office

U.S. Department of Justice

Federal Bureau of Investigation

RECEIVED
APR 30 2 50 PM '81
OFFICE OF SECURITY
AND INVESTIGATIONS

In Reply, Please Refer to
File No.

Dallas, Texas
April 8, 1981

LEONARD MERRELL SMITH - BORROWER,
PRODUCTION CREDIT ASSOCIATION (PCA), D21-4
PLAINVIEW, TEXAS
FRAUD AGAINST THE GOVERNMENT -
SMALL BUSINESS ADMINISTRATION

Leonard Merrell Smith, as well as an undetermined number of other borrowers, were the receipients of Small Business Administration (SBA) Farm Disaster loans. These loans were made at a preferential interest rate (five percent) at a time when the general money market rates were in excess of 18 percent. Smith used the SBA loan proceeds to purchase debentures issued by the Federal Intermediate Credit Bank (FICB). These debentures paid the purchaser a return of 15.35 percent per annum. The transaction resulted in passive income to the farmer of 10.35 percent, on Farm Disaster loan proceeds in excess of $250,000.

It should be noted that the FICB debentures are the source instruments for funds used to make PCA loans. By purchasing the FICB debentures, borrowers furnished the PCA with lendable funds. Smith thereafter borrowed these funds back from the PCA, and utilized them for his annual farm operating expenses. His cost of the PCA borrowed funds is approximately 12 percent per annum.

The net effect of all transactions was to reduce a farmers cost of funds from the SBA rate of five percent to an effective rate of 1.65 percent.

Upon interview, Smith stated the entire series of financial transactions were initiated at the request of Plainview, Texas PCA officials. These same officials are the individuals responsible for the issuance of the FICB debentures, and for the origination of PCA farm operating loans.

Facts of captioned matter were discussed with Assistant U.S. Attorney (AUSA) Clint Averitte, Lubbock, Texas, Northern District of Texas (NDT), on numerous occasions since December 1, 1980. AUSA Averitte stated it is his opinion that no false statements were submitted to the SBA in procuring the farm disaster loans. However, he stated the actions may constitute a violation of Title 18, U.S. Code, Section 1006 (False Statements to Federal Credit Institutions), and requested sufficient investigation be conducted in order to render a final prosecutive opinion.

MRS
4/15/80
File

APR 15 1980

District Director
Lubbock, Texas

Office of Inspector General AIG/I (80-76)

Leonard Merrell Smith
FDLB 403611 2001LUB

Your memorandum of March 14, 1980, requesting an investigation of the subject borrower, was received in this office on April 10, 1980.

Based upon allegations contained in your memorandum, an investigation on the subject borrower will be scheduled. You will be notified when an Investigator is available for the file review.

Should you have any questions, please contact me.

R.R. Rousche
Assistant Inspector General
for Investigations

CLEARED:

Marvin P. Shelton
Marvin P. Shelton, Director

jkr
OFI:JKReeves:tj 4/14/80

MAY 29 1980
FA2 -65- 5

mps
6/26/80
File

CLEARED:

Marvin P. Shelton
Marvin P. Shelton, Director

OFI:JBForeman:tj 6/25/80

JUN 25 1980

District Director
Lubbock, Texas

Office of Inspector General AIG/I

Leonard M. Smith
Muleshoe, Texas
FDLB-403,611-2001-LUB

Enclosed are two copies of the investigation report on the subject borrower. A set of exhibits supporting the information contained in the report is maintained in the Office of Financial Investigations.

The report indicates that Mr. Smith may have violated Federal Statutes by not using proceeds from the SBA loan as authorized. Mr. Smith purchased $250,000 of Federal Intermediate Credit Bank bonds which were used as collateral for a line of credit loan from the Plainview Production Credit Association (PCA). However, the funds received from PCA appear to have been used in the farming operations of Mr. Smith.

We recommend that the borrower be required to repay the loan immediately and that he be required to return the interest earned on the government funds he invested.

Please advise this office within 30 days of the action taken on this report. Any action taken should be coordinated with the Assistant United States Attorney in Lubbock.

A copy of this report has been furnished to the United States Attorney for whatever action he deems appropriate.

Should you have any questions or if this office can be of further assistance, please let me know.

mps
For R.R. Reusche
Assistant Inspector General
for Investigations

Enclosures

JUN 26 1980
FA2 65 8

mps
6/26/80
F.Ye

Honorable Kenneth J. Mighell
United States Attorney
310 U. S. Courthouse
10th & Lamar Streets
Ft. Worth, Texas 76102

JUN 25 1980

Attention: Ms. Pauline M. Jacobo
Assistant U. S. Attorney (Lubbock)

Re: Leonard M. Smith
Muleshoe, Texas

Dear Mr. Mighell:

Enclosed is a copy of the investigation report on the subject borrower. Also enclosed is a set of exhibits supporting the information contained in the report.

As discussed with Ms. Jacobo, by a member of my staff, it appears that Mr. Smith possibly violated Federal Statutes by purchasing $250,000 of Federal Intermediate Credit Bank bonds with SBA loan proceeds rather than as authorized. These bonds are being held as collateral by the Plainview Production Credit Association (PCA) for its line of credit loan to Mr. Smith. Proceeds from the line of credit loan appears to have been used in the farming operations. However, Mr. Smith has earned interest on the government funds of over $2,000.

Should you have any questions or if this office can be of further assistance, please let me know.

Sincerely,

For R. R. Rausche
Assistant Inspector General
for Investigations

CLEARED:

Marvin P. Shelton
Marvin P. Shelton, Director, FI

FI:JBForeman:tj:aj 6/26/80

JUN 26 1980

FA2 -65- 7

U. S. SMALL BUSINESS ADMINISTRATION
712 FEDERAL OFFICE BUILDING & COURTHOUSE
1205 TEXAS AVENUE
LUBBOCK, TEXAS 79401
TELEPHONE 806-762-7462

July 18, 1980

Agent Paul Miller
Federal Bureau of Investigation
1205 Texas Avenue, 6th Floor
Lubbock, Texas 79401

Re: Leonard Merrell Smith
FDLB-403611-2001-LUB

Dear Mr. Miller:

The SBA disbursed a disaster loan in the total principal amount of $500,000.00 in February, 1980 to the above-referenced individual for 1979 crop loss. The SBA loan authorization provided for approximately $250,000.00 for debt repayment to Production Credit Association (PCA) and approximately $250,000.00 for crop production expenses. In his "Receipt For and Certification of Use of Proceeds", Smith certified that the proceeds had been or would be used for new crops as set forth in an attached schedule of expenses. The loan proceeds were not, however, used for production of the new crops as certified.

In late March of 1980, SBA received a request for subordination of its liens to PCA, who was making the borrower an additional loan for crop production expenses. Upon requesting and receiving an updated financial statement on the borrower, SBA discovered that the $250,000.00 which was to be used for crop production expenses had been invested in FICB debentures. Those FICB bonds were then used as part of the collateral on the Plainview PCA loan to the borrower for his 1980 crop production. At the time Smith signed the certification of use of proceeds on March 4, 1980, he had apparently already used the proceeds of the SBA loan to buy FICB bonds. This use of SBA loan proceeds is a flagrant violation of the Disaster Relief Act because of misuse of loan proceeds, and may also constitute criminal violations for false statements, mail fraud and conspiracy to defraud the United States (15 U.S.C. §645a, 18 U.S.C. §1001, 42 U.S.C. §5157 and 18 U.S.C. §§371 and 1341).

Our farm disaster servicing loan officers have been concerned and suspicious that this type of irregularity has been a continuing problem with Plainview PCA. PCA apparently encourages its borrowers who obtain SBA loans to convert the loan proceeds to debentures. PCA then loans the farmer his production expenses, utilizing the debentures as collateral and 3% government money to

JUL 24 1980

FA2-65-9

Agent Paul Miller
July 18, 1980
Page Two

finance its operation. Not only is this a misuse of funds, but it also places other lenders who are trying to comply with federal guidelines and regulations at an unfair disadvantage. Our records reflect other farms who have utilized SBA loan proceeds in the same manner, at PCA's suggestion. Some of those include:

Gene Smith
Lazbuddie, Texas
FDLB-403960-2001-LUB

Eddie J. Hall
Friona, Texas
FDLB-138452-2009-LUB

Smith's records and additional information regarding other similar instances may be obtained from myself or Charles Jackson at the SBA District Office in the Federal Building, Lubbock, Texas. Thank you for your assistance in this matter. Hopefully, your investigation will enable use to determine the magnitude of this problem with regard to other borrowers and all branches of PCA in Plainview.

Sincerely,

Barbara Hoffman

Barbara K. Hoffman
Attorney-Advisor

CC: R.R. Reusche
Asst. Inspector General
for Investigations
Washington, D.C.

August 14, 1980

CERTIFIED MAIL - RETURN RECEIPT REQUESTED

Mr. Leonard Merrell Smith
Route #1
Muleshoe, Texas 79347

Re: SBA Loan #FDLB-703611-2001-LUB

Dear Mr. Smith:

As you are probably aware, an investigation report conducted by the Office of the Inspector General of Small Business Administration reveals that you misused disaster loan funds. Your not using the proceeds as authorized was in violation of the Disaster Relief Act of 1974, 15 U.S.C. §645(a), 18 U.S.C. §1001, 42 U.S.C. §§5157, 317(a) & (c), 18 U.S.C. §1341 and 18 U.S.C. §371, which provide for civil and criminal penalties for violations of the Act. SBA hereby demands full payment of the $500,000.00 loan proceeds and return of the interest earned on the funds invested.

Please forward a chasier's check to this office or appear in person within ten (10) days from your receipt of this letter. If you do not respond within that time, SBA will proceed with all necessary legal action to protect the government's interest.

Sincerely,

J. W. Gilbert
Chief Portfolio Management

bcc: Office of Inspector General
Washington, D. C.

August 20, 1980

J. W. Gilbert
Chief, Portfolio Management
Small Business Administration
1205 Texas Avenue
Lubbock, Texas 79401

Dear Mr. Gilbert:

After meeting with you and Charles Jackson and Barbara Hoffman regarding the misuse of proceeds on my SBA loan, I would like to make the following proposal. I have enclosed a current financial statement which will show that I am unable to pay the $500,000.00 requested at this time. I have had to borrow additional operating money from PCA just this week and will probably have to get more money from PCA before my operating year is completed. My SBA payments are already provided for through my PCA loan and will be paid on their regular schedule.

I request at this time that you allow me to make a partial reduction of the $250,000.00 which was placed in PCA FICB bonds by two $10,000.00 payments -- one by September 30 and one by January 15, 1981. In addition, if I am able to derive any net proceeds from my cotton crop this Fall I'll make additional reduction in the $250,000.00.

I hope this meets your approval since I presently have no other means of paying. Please let me know if there are any additional papers I should sign.

Sincerely,

L M Smith
L. M. Smith

MRS
9/15/8
File

SEP 1 5 1980

District Director
Lubbock, Texas

Office of Inspector General AIG/I (FA2-65)

Leonard M. Smith
Muleshoe, Texas
FDLB-403,511-2001-LUB

On June 25, 1980, we sent you copies of the investigation report on the subject account and requested that we be advised within 30 days of the action taken on the report. We recommended that the borrower be required to repay the loan immediately and return the interest earned on the government funds he invested.

On August 5, 1980, your Attorney-Advisor reported by telephone that a demand letter had been sent to the borrower and promised us a copy of the letter for our files. To date, the copy has not been received.

I would appreciate being advised as to the current status of your resolution of this matter and further, being furnished a copy of the demand letter sent to Smith.

Your cooperation is appreciated.

/s/

R. R. Reuscne
Assistant Inspector General
for Investigations

9/16/80
DATE
FA2-65 12

CLEARED:

Marvin P. Shelton

~~Marvin~~ Marv P. Shelton
Director, OFI

OIG:OFI:DHolland:bf 9/12/80

U.S. SMALL BUSINESS ADMINISTRATION
712 FEDERAL OFFICE BUILDING & COURTHOUSE
1205 TEXAS AVENUE
LUBBOCK, TEXAS 79401
TELEPHONE 806-762-7502

September 19, 1980

R.R. Reusche
Assistant Inspector General
for Investigations
1441 "L" Street N.W.
Washington, D.C. 20416

FROM: District Director
Lubbock, Texas

RE: O Leonard M. Smith
Muleshoe, Texas
FDLB 403611 2001LUB

On August 14, 1980, a demand letter was mailed to the borrower. Mr. C.H. Jackson of our Farm Servicing Division states that he forwarded a copy to your office shortly thereafter. Since you have not received it, another copy is enclosed.

Also enclosed is a copy of a letter from the borrower setting out his offer of terms to try to correct this problem. On August 20, 1980, Charles Jackson, Disaster Loan Specialist, Barbara Hoffman, Attorney-Advisor, and J.W. Gilbert, Chief, P.M. met with borrower and his wife in the SBA office in Lubbock. After much deliberation it was determined that the only way the borrower could stay in business and ever hope to pay his debts was as described in borrower's letter.

We feel the possible violation resulting in the probable misuse of funds was caused by pressure from the Plainview PCA and not a voluntary act by our borrower. Also borrower has agreed to cooperate with the F.B.I. and has already been interviewed once.

Therefore, we believe the terms offered by Mr. Smith are reasonable and to the best interest of the government.

Russell R. Berry

Russell R. Berry
District Director

e 9/26/80
SEP 26 1980
FA7 -65 13

FACT SHEET

BORROWER: Dawson Brothers Farm
Hawkinsville, Georgia

SBA DISTRICT: Atlanta

TYPE OF BUSINESS: Farm. Produces corn, cotton, peanuts and soybeans

AMOUNT OF SBA DISASTER LOAN: $350,000

TERMS OF LOAN: Maturity is ten years from date of loan with interest rate of 3% on first $250,000 and 6 5/8% on remaining balance

DISBURSEMENT DATE: November 9, 1977 and February 28, 1978

TYPE OF DISASTER: Drought

SBA LOAN HISTORY

The SBA authorized a $350,000 loan to the Dawson Brothers Farm in October 1977. The farming operation suffered a loss during the 1977 drought and was eligible for a loan of $476,000. The Dawson Brothers signed a certification of use of proceeds stating that they would use the loan proceeds for debt repayment and crop production expenses.

SBA INSPECTOR GENERAL FINDINGS

The Dawson Brothers Farm received a $350,000 disaster loan from SBA and failed to notify SBA of a $10,176.16 grant from the Agriculture Stabilization and Conservation Service (ASCS) for an identical loss. The borrower failed to notify SBA of this grant as required by the loan authorization and agreement. In addition, Title 42, U.S.C. Section 5155 prohibits duplication of Federal disaster assistance.

The Dawson Brothers received an SBA loan based on an estimated loss of $476,901. The actual loss due to the drought was only $142,889. Therefore the borrowers received a loan which was $207,111 in excess of their actual loss. The loan authorization and agreement require the borrower to notify SBA if their actual loss is less than their estimated loss so that the loan may be adjusted accordingly. The Dawson Brothers failed to notify SBA of this increase in their actual production figure.

The loan documents permitted the Dawson Brothers to use half of the loan proceeds for working capital and half for producing the next years crop. The borrowers did not use any funds for producing the next years crop. Instead, they placed $175,000 into a certificate of deposit and used $25,000 to repay debts.

SBA ACTION

The SBA Atlanta District Office demanded repayment of the excess crop yield, ASCS payment, and misused portion of the loan proceeds in June 1981. As of August 31, 1981 they have not collected any of these excess payments.

BORROWER COMMENT

John, Gary and Rodney Dawson admitted that they placed $175,000 into a certificate of deposit. However, they claimed that they borrowed money from private lenders and spent at least $175,000 in their farming operation during 1978. As of August 31, 1981 the Dawson Brothers have been unable to prove they used this amount to produce the 1978 crop.

The borrowers also admitted receiving an ASCS payment but claim they were never aware of the requirement to notify SBA of this grant. Regarding the excess crop yield, the borrowers stated only that they did not understand how this figure was determined.

The Dawson Brothers have so far refused to repay these excess monies to the SBA. They argue that although they received a loan far in excess of their actual loss, and misused a substantial portion of it, they should not be required to repay SBA in one lump sum, but should be permitted to repay the excess over the life of the loan.

SMALL BUSINESS ADMINISTRATION
Atlanta, Georgia
and
JOHN W. DAWSON, JR., RODNEY P. DAWSON
AND GARY DAWSON,
d/b/a DAWSON BROTHERS FARMS
Hawkinsville, Georgia

LOAN NUMBER DBL-898-106-10-06-ATL
REPORT NUMBER 7(b)-80-04-05-033

OPALACK & COMPANY
ONE HUNDRED SOUTH ROYAL STREET
ALEXANDRIA, VIRGINIA 22314
(703) 836-6701

23 January 1980

Director
Office of Regulatory Audits
Office of Inspector General
U.S. Small Business Administration
1441 L Street, N.W.: Room M-1
Washington, D.C. 20416

Dear Sir:

We have performed a limited-scope compliance audit in accordance with the terms and conditions of Contract Number SBA-1575-AUD-78 relating to the loan extended by the U.S. Small Business Administration (SBA), under the Section 7(b) Loan Program to John W. Dawson, Jr., Rodney P. Dawson and Gary Dawson, d/b/a Dawson Brothers Farms, Loan Number DBL-898-106-10-06-ATL, in the amount of $350,000.

The extent of audit procedures required in performing this compliance audit is stated in the Scope of Audit section of this report.

This report is intended for use in connection with the contractual and regulatory provisions of the Loan Authorization and Loan Agreement to which it refers and should not be used for any other purpose, including association with the financial statements of John W. Dawson, Jr., Rodney P. Dawson and Gary Dawson, d/b/a Dawson Brothers Farms.

Very truly yours,

OPALACK & COMPANY

By: Thomas K Fahey
Thomas K. Fahey, CPA
Project Manager

TKF:fjc

TABLE OF CONTENTS

	Page
AUDIT SUMMARY	3
INTRODUCTION AND BACKGROUND	5
SCOPE OF AUDIT	6
RESULTS OF AUDIT	7
Unauthorized Use Of Proceeds	7
Excess Loan Amount Not Reapplied	8
Other Disaster Payments Not Reported	9
Actual Crop Yield Not Reported	9
Compensation Agreement Violations	10
Incomplete Loan Agreement	11
Inadequate Records	12
Financial Statements Not Submitted	13
Flood Insurance Not Obtained	13
SBA Loan Servicing Violations	14
OTHER MATTERS TO BE REPORTED	16

AUDIT SUMMARY

Our examination of the loan file of the SBA's Atlanta District Office was completed on 23 January 1980. The results of that examination are as of that date. Our examination of the borrower's books and records was completed on 16 January 1980. The results of that examination are as of that date.

The findings disclosed by this audit are summarized below:

- Contrary to the provisions of the Loan Authorization, the borrower used approximately $25,000 to repay debts owed to a bank and invested $175,000 in a certificate of deposit.
- The amount of the loan in excess of the amount used as authorized, $175,000, was not reapplied to the loan as required.
- The borrower did not report the 1977 disaster payments totaling $10,176.60 received from the Agriculture Stabilization and Conservation Service (ASCS) as required.
- The borrower did not report the actual 1977 crop yield as required to adjust the amount of the loan.
- The borrower's accountant did not submit a Compensation Agreement disclosing the $575 fee charged in connection with the loan, and the Compensation Agreement submitted by the borrower's attorney did not itemize the fees charged as required.
- The Loan Agreement which was executed for this loan did not contain all the terms and conditions specified in the Loan Authorization.
- The borrower does not maintain adequate books and records as required.

- The borrower does not submit financial statements or tax returns as required.
- The borrower has not obtained Federal Flood Insurance and neither the borrower nor the SBA could provide evidence that such insurance was not available.
- The SBA has not serviced this loan in accordance with the terms of the Loan Authorization and the Standard Operating Procedures established by the SBA.

The results of this audit were discussed as applicable with Mr. John W. Dawson, Jr., Mr. Rodney P. Dawson, and Mr. Gary Dawson, d/b/a Dawson Brothers Farms (borrower), Mr. Ronnie Futch, the accountant for Dawson Brothers Farms and Mr. Max Houston, Disaster Branch Manager of the SBA. Their comments are included in this report where appropriate.

INTRODUCTION AND BACKGROUND

In accordance with the terms of Contract Number SBA-1575-AUD-78 with the Small Business Administration (SBA), a compliance audit was made of the Authorization dated 6 October 1977 and Loan Agreement dated 8 November 1977 which authorized a direct loan to John W. Dawson, Jr., Rodney Dawson and Gary Dawson, d/b/a Dawson Brothers Farms in the amount of $350,000. The disaster under which this loan was authorized was a drought during 1977.

The borrower was established in 1976 and is engaged in the business of operating a farm. The business operates on a fiscal year ending 31 December and employs the cash method of accounting. The owners are John W. Dawson, Jr., Rodney P. Dawson and Gary Dawson, each owning 33 percent.

A balance sheet was not available from the borrower; however, the borrower's statement of operations for the eleven-month period ending 30 November 1979 disclosed total revenue of $539,828 for the period with net income of $109,406.

The borrower received $10,176.60 in disaster payments from the Agriculture Stabilization and Conservation Service during 1977; these payments were not reported to the SBA.

SCOPE OF AUDIT

The scope of the compliance audit was limited to an examination of the books and records of the Dawson Brothers Farms and tests of the SBA loan files. The audit objective was to determine if the Dawson brothers had complied with applicable laws and regulations of the Section 7(b) Business Loan Program and the contract terms and conditions of the Loan Authorization and Loan Agreement.

The extent of audit procedures required in performing the compliance audit was guided by the General Accounting Office publication, Standards for Audit of Governmental Organizations, Programs, Activities and Functions and the generally accepted auditing standards promulgated by the American Institute of Certified Public Accountants. However, inasmuch as the standards just mentioned apply to full-scope audits, some of the standards are not applicable to a limited-scope compliance audit. Such standards were observed where applicable.

RESULTS OF AUDIT

Based upon our audit, we believe that John W. Dawson, Jr., Rodney P. Dawson, and Gary Dawson, d/b/a Dawson Brothers Farms have not complied with the requirements of the SBA Loan Authorization and Loan Agreement as stated in the following conditions:

Unauthorized Use Of Proceeds

Contrary to the provisions of the Loan Authorization, the borrower used approximately $25,000 to repay debts owed to a bank and invested $175,000 in a certificate of deposit.

The Loan Authorization, SBA Form 305, Paragraph 5, specified the use of loan proceeds as follows:

- Approximately $175,000 and any remaining proceeds payable to the borrower for working capital.
- Approximately $175,000 and any remaining proceeds payable to the borrower to be used in planting next year's crops.

The borrower used approximately $25,000 of the first loan disbursement to repay debt owed to a bank. The second disbursement of $175,000 was not spent in the borrower's farming operation. Instead, it was put into a certificate of deposit. Neither the borrower nor the accountant could provide evidence that the borrower had had $175,000 in operating capital prior to the disaster which was used to operate the business during the disaster. We recommend that the borrower repay the U.S. Small Business Administration $262,500 which is 1.5 times the amount of the loan proceeds which were misapplied in accordance with Paragraph 123.17,CFR Parr. 123.

Mr. Futch, the accountant for Dawson Brothers Farms, commented that the Loan Application specified that the use of loan proceeds would be to replace the borrower's own funds and pay the bank note. Mr. Houston of the SBA commented that interim financing or replacement of the borrower's own funds is an acceptable use of loan proceeds.

Excess Loan Amount Not Reapplied

The amount of the loan in excess of the amount used as authorized, $175,000, was not reapplied to the loan as required.

The Loan Authorization, Paragraph 12, requires the borrower to agree that in the event that the authorized amount of the loan is in excess of the amount required to accomplish the purposes of the loan as set forth in Paragraph 5 hereof, then, at the discretion of the Disaster Branch Manager, the authorized amount of the loan will be reduced by the amount equal to such excess amount or such excess amount shall be applied on the installments of the principal owing on the note in the inverse order of maturity.

As previously mentioned, the borrower did not use the second half of the loan, $175,000, for farming operations as authorized. However, this excess amount has not been applied to the loan, nor was SBA notified that the authorized amount of the loan was in excess of the amount actually used in the borrower's business.

Other Disaster Payments Not Reported

The borrower did not report the 1977 disaster payments totaling $10,176.60 received from the Agriculture Stabilization Conservation Service (ASCS) as required.

The Loan Authorization, Paragraph 14e, required the borrower to notify the SBA prior to loan disbursement of any and all financial assistance received from or applied for from ASCS or any other federally funded lending agency.

During 1977, the borrower received $10,176.60 from ASCS for the disaster losses sustained on the borrower's corn and cotton crops. The SBA was not notified of these payments.

Actual Crop Yield Not Reported

The borrower did not report the actual 1977 crop yield as required to adjust the amount of the loan.

Paragraph 14d of the Authorization required the borrower to notify the SBA if the total 1977 crop yield of each crop exceeded the estimated yield so that the SBA could adjust the amount of the loan accordingly.

The borrower did not notify the SBA of the actual 1977 crop yield although the actual yield far exceeded the estimated yield. The following is a summary of the estimated yield, the actual yield and the final amount of loss as adjusted for ASCS payments:

	Corn	Soybeans	Cotton	Peanuts	Total
Anticipated income prior to disaster	$69,940	$79,300	$248,820	$207,446	$605,506
Estimated loss	69,940	79,300	223,938	103,723	476,901
Anticipated income after disaster	0	0	24,882	103,723	128,605
Actual income, 1977	*	19,453	210,914	222,073	452,440
Actual income in excess of anticipated income		$19,453	$186,032	$118,350	323,835
Payments from ASCS for disaster					10,177
Total (actual dollar value of crops and other federal payments in excess of need)					$334,012

*The income specifically from the sale of corn could not be determined.

Thus, instead of incurring a $476,901 loss from the disaster as estimated by the borrower, the Dawson Brothers only sustained a $142,889 loss from the drought.

Mr. Dawson stated that crop yield reports for corn, cotton and peanuts were submitted to ASCS. The SBA had no comment.

Compensation Agreement Violations

The borrower's accountant did not submit a Compensation Agreement disclosing the $575 fee charged in connection with thw loan, and the Compensation Agreement submitted by the borrower's attorney did not itemize the fees charged as required.

The Settlement Sheet, SBA Form 1050, states that the borrower certifies that no fees have been or will be paid, directly or indirectly, other than those reported on SBA Forms 4 or 159; it is understood that all fees not approved by the SBA are prohibited.

As disclosed in the borrower's Application for Loan, the borrower was charged $575 by Walker, Meadors & Vickers, accountants for their assistance in preparing the SBA Loan Application. A Compensation Agreement was not submitted for this fee nor was there evidence that the SBA followed up on the lack of a Compensation Agreement although this fee was disclosed in the borrower's Loan Application. The Compensation Agreement submitted by J. John Hall, the borrower's attorney, shows total compensation of $750. This compensation was not itemized showing each date the services were performed, the times of each day and describing the services rendered on each day listed. Instead, the itemization merely summarized the amount of hours it took to provide the various services to the borrower.

Neither the SBA nor the borrower had any comment.

Incomplete Loan Agreement

The Loan Agreement which was executed for this loan did not contain all the terms and conditions as specified in the Loan Authorization.

The Loan Agreement did not contain the following conditions which were specified in the Loan Authorization:

- The agreement of the borrower that the excess amount of the loan would be reapplied.
- That the borrower was to provide insurance, including comprehensive coverage, with loss payable clause in favor of the SBA in the amounts and for such risks as was satisfactory to the SBA.
- The borrower's agreement to purchase Federal Flood Insurance if available.
- The requirement to provide annual signed and dated financial statements or federal income tax returns for the period beginning 31 December 1977. The Loan Agreement only required the borrower to begin submitting statements with the period ending 31 December 1978.
- The condition requiring the borrower to notify the SBA if the total 1977 crop yield of each crop exceeded the estimated yield so that the SBA could adjust the amount of the loan accordingly.
- That prior to any disbursement, the borrower would submit to the SBA the particulars of any and all financial assistance received from or applied for from federally funded lending agencies.

Neither the borrower nor the SBA had any comment.

Inadequate Records

The borrower does not maintain adequate books and records as required.

The Loan Agreement, Paragraph 3, requires the borrower to at all times keep proper books of account in a manner satisfactory to the SBA.

The borrower's records are considered to be inadequate because the borrower is on a cash basis and the records maintained for fiscal years 1977 and 1978 did not include a general ledger or a general journal or any other system necessary to summarize the transactions of the balance sheet and income statement accounts. Also, the borrower's records were only posted through November 1979.

The borrower had no comment. Mr. Houston of the SBA commented that the borrower's records should be better in the future.

Financial Statements Not Submitted

The borrower does not submit financial statements or tax returns as required.

The Loan Authorization, Paragraph 14(c), required the borrower to provide annual signed and dated financial statements or copies of Federal income tax returns beginning 31 December 1977 and annually thereafter.

The SBA did not have a copy of the borrower's financial statements or tax returns for the years ending 31 December 1978 and 1977.

The borrower's commented that they were not aware of this requirement. Mr. Houston of the SBA commented that financial statements were requested but were not received.

Flood Insurance Not Obtained

The borrower has not obtained Federal Flood Insurance and neither the borrower nor the SBA could provide evidence that such insurance was not available.

The Loan Authorization, Paragraph 14(a), required the borrower to purchase Federal Flood Insurance if the business or any collateral was located in or became located in a special flood hazard area and Federal Flood Insurance was available.

The borrower has not obtained Federal Flood Insurance and neither the SBA nor the borrower could provide evidence that such insurance was not available.

The borrower commented that the business is not located in a flood zone. Mr. Houston of the SBA had no comment.

SBA Loan Servicing Violations

The SBA has not serviced this loan in accordance with the terms of the Loan Authorization and the Standard Operating Procedures established by the SBA.

The SBA did not obtain the following required documents:

- Settlement Sheets. The Settlement for the first disbursement of the loan was not accurate in that it states that the loan was disbursed in trust to the borrower's attorney; there was no evidence that this had been done. Also, the SBA did not prepare a Settlement Sheet, SBA Form 1050, for the last disbursement of the loan.
- The SBA did not obtain a Completion Certificate for Disaster Loans, SBA Form 1018.
- The SBA did not obtain a Certification of Use of Proceeds from the borrower for the last disbursement of the loan.
- The SBA did not obtain an After-acquired Property Agreement from the borrower as required by Paragraph 7 of the Loan Authorization.

Regarding the SBA Form 1018, Mr. Houston of the SBA commented that he does not believe that this form is used. Regarding the lack of Settlement Sheets and the incorrect Settlement Sheet, Mr. Houston commented that the check itself would suffice as to how the loan was disbursed and a Settlement Sheet was not necessary. Regarding the lack of an After-acquired Property Agreement, Mr. Houston commented that this condition should have been deleted from the Loan Authorization.

OTHER MATTERS TO BE REPORTED

The borrower has incurred additional debt since the SBA loan, some of which has been repaid. However, the borrower could not provide evidence that this debt was either unsecured or secured by collateral other than that securing the SBA loan.

FACT SHEET

BORROWER:	Everidge Brothers Farm Lilly, Georgia
SBA DISTRICT:	Atlanta
TYPE OF BUSINESS:	Farm
AMOUNT OF SBA DISASTER LOAN:	$892,300
TERMS OF LOAN:	Maturity is 20 years from date of loan with 3% annual interest on the first $250,000 and 6 5/8% interest on the remaining principal
DISBURSEMENT DATE:	April 5, 1978
TYPE OF DISASTER:	Drought

SBA LOAN HISTORY

On September 7, 1977, the Everidge Brothers Farm applied to the Atlanta District Office for a Farm Disaster Loan based on losses due to drought conditions. On January 18, 1978, the Atlanta Office duly authorized a loan to the Farm in the amount of $892,300, half to be used for debt repayment, with the second half to be used in planting the 1978 crop. Marcus and Ronnie Everidge, owners of the farm, signed a certification of use of proceeds stipulating that the funds would be used for the purposes authorized.

SBA INSPECTOR GENERAL FINDINGS

The borrower was required to notify SBA if the actual 1977 crop yield was in excess of the estimated crop yield. Everidge Brothers Farm received their loan based on an estimated loss of $920,311. The actual loss due to drought was only $506,585. Therefore, the excess loan paid to Everidge Brothers Farm totaled $385,715.

The Farm also received a $34,315 grant from the Agriculture Conservation and Stabilization Service for a loss identical to the one covered by the SBA Disaster Loan. The farm did not notify SBA of the duplicate grant, as required by the loan authorization. Title 42, U.S.C. Section 5155 prohibits duplication of Federal disaster assistance.

The entire amount of the loan was used by the borrower to reduce indebtedness although only half of the loan had been authorized for debt reduction. The borrower's private indebtedness amounted to $938,516 as of January 1, 1978, 17 days before the SBA loan was authorized. Therefore, the borrower could not have used the SBA proceeds to repay an interim operating loan, which possibly could have justified the debt repayment.

SBA ACTION

The Atlanta District Office demanded repayment of the excess payments. Collection has not yet been accomplished.

BORROWER COMMENT

The Everidge Brothers commented that the debt repayment was for interim financing obtained while waiting disbursement of the SBA funds. They also stated that SBA should have been aware of the excess crop yields because of information on 1977 tax returns submitted to SBA. The borrower had no comment regarding the duplicate payments.

SMALL BUSINESS ADMINISTRATION
Atlanta, Georgia
and
M. W. AND R. J. EVERIDGE,
D/B/A EVERIDGE BROTHERS FARM
Lilly, Georgia
LOAN NUMBER DLB-959-791-10-01-ATL
REPORT NUMBER 7(b)-80-04-05-014

OPALACK & COMPANY
ONE HUNDRED SOUTH ROYAL STREET
ALEXANDRIA, VIRGINIA 22314
(703) 836-6701

30 January 1980

Director
Office of Regulatory Audits
Office of Inspector General
U.S. Small Business Administration
1441 L Street, N.W.; Room M-1
Washington, D.C. 20416

Dear Sir:

We have performed a limited-scope compliance audit in accordance with the terms and conditions of Contract Number SBA-1575-AUD-78 relating to the loan extended by the U.S. Small Business Administration (SBA), under the Section 7(b) Loan Program to M. W. and R. J. Everidge, d/b/a Everidge Brothers Farm, Loan Number DLB-959-791-10-01-ATL, in the amount of $892,300.

The extent of audit procedures required in performing this compliance audit is stated in the Scope of Audit section of this report.

This report is intended for use in connection with the contractual and regulatory provisions of the Loan Authorization and Loan Agreement to which it refers and should not be used for any other purpose, including association with the financial statements of M. W. and R. J. Everidge, d/b/a Everidge Brothers Farm.

Very truly yours,

OPALACK & COMPANY

By: Thomas K. Fahey
Thomas K. Fahey, CPA
Project Manager

TKF:acr

TABLE OF CONTENTS

	Page
AUDIT SUMMARY	3
INTRODUCTION AND BACKGROUND	5
SCOPE OF AUDIT	7
RESULTS OF AUDIT	8
Use Of Proceeds	8
Standby Agreement Not Obtained	9
Excess Crop Yield Not Reported	10
Payments From Other Federal Agencies Not Reported	11
Compensation Agreement Not Submitted	11
Incomplete Loan Agreement	12
Inadequate Records	12
Financial Statement Not Submitted	13
Insurance Not Obtained	13
Loans To Employees	14

AUDIT SUMMARY

Our examination of the loan file of the SBA's Atlanta District Office was completed on 30 January 1980. The results of that examination are as of that date. Our examination of the borrower's books and records was completed 21 January 1980. The results of that examination are as of that date.

The findings disclosed by this audit are summarized below:

- The borrower used the entire amount of the loan to reduce indebtedness although only half of the loan had been authorized for debt reduction.
- A Standby Agreement was not obtained from the Cordele Production Credit Association as required.
- The borrower did not report the actual crop yield which was in excess of the estimated crop yield for 1977 as required by the Loan Authorization.
- The borrower did not report the payments of $34,315.20 received from another federal agency as required.
- A Compensation Agreement was not submitted for the $2,617.50 fee charged by the borrower's accountant in connection with the loan.
- The Loan Agreement which was executed for this loan did not contain all the terms and conditions set forth in the Loan Authorization as required.
- The borrower does not maintain adequate books and records as required.
- The borrower has not submitted financial statements as required.
- It could not be determined that hazard and flood insurance had been obtained as required.
- The borrower has extended loans to its employees contrary to the terms of the Loan Agreement.

The results of this audit were discussed as applicable with Mr. Ronnie Everidge and Mr. M. W. Everidge (borrower), Mr. East, the borrower's accountant, Mr. Roberts, the borrower's lawyer, and Mr. Ronnie Kitchens from Cordele Production Credit Association. The results of the audit were also discussed with Mr. Max Houston, Disaster Branch Manager of the SBA. Their comments are included in this report where appropriate.

INTRODUCTION AND BACKGROUND

In accordance with the terms of Contract Number SBA-1575-AUD-78 with the Small Business Administration (SBA), a compliance audit was made of the Authorization dated 18 January 1978 and Loan Agreement dated 5 April 1978 which authorized a direct loan to M. W. and R. J. Everidge, d/b/a Everidge Brothers Farm in the amount of $892,300. The disaster under which this loan was authorized was a drought during 1977.

The borrower was established in 1961 and is engaged in the business of operating a farm. The business operates on a fiscal year ending 31 December and employs the cash method of accounting. The partnership is in the process of being divided into two sole proprietorships owned by Marcus W. Everidge and Ronnie J. Everidge. The SBA had not completed the documentation necessary to divide the loan as of the date of this audit.

Financial statements for Marcus Everidge Farms for the eleven-month period ending 30 November 1979 disclose assets of $1,050,288, liabilities of $1,112,448 and a deficit owner's equity of $62,160. Gross income for the period was $169,309 with net income of $117,338. Financial statements for Ronnie Everidge Farms for the eleven-month period ending 30 November 1979 disclose assets of $1,191,585, liabilities of $1,012,083 and owner's equity of $179,502. Gross income for the period was $219,933 with net income of $174,695.

The borrower received $34,315.20 from the Agriculture Stabilization and Conservation Service during 1977 for the corn and cotton crop loss due to the disaster; the SBA was not informed of this payment.

SCOPE OF AUDIT

The scope of the compliance audit was limited to an examination of the books and records of M. W. and R. J. Everidge, d/b/a Everidge Brothers Farm and tests of the SBA loan files. The audit objective was to determine if the borrower had complied with applicable laws and regulations of the Section 7(b) Business Loan Program and the contract terms and conditions of the Loan Authorization and Loan Agreement.

The extent of audit procedures required in performing the compliance audit was guided by the General Accounting Office publication, Standards for Audit of Governmental Organizations, Programs, Activities and Functions and the generally accepted auditing standards promulgated by the American Institute of Certified Public Accountants. However, inasmuch as the standards just mentioned apply to full-scope audits, some of the standards are not applicable to a limited-scope compliance audit. Such standards were observed where applicable.

RESULTS OF AUDIT

Based upon our audit, we believe that M. W. and R. J. Everidge, d/b/a Everidge Brothers Farm have not complied with the requirements of the SBA Loan Authorization and Loan Agreement as stated in the following conditions:

Use Of Proceeds

The borrower used the entire amount of the loan to reduce indebtedness although only half of the loan had been authorized for debt reduction.

The Loan Authorization, Paragraph 5, specified the use of loan proceeds as follows:

- Approximately $446,150 to liquidate or reduce amounts owed to creditors and/or lenders as listed in this Authorization.
- Approximately $446,150 and any remaining proceeds to be used in planting next year's crops.

The entire amount of the loan was deposited by the borrower into a checking account. The Settlement Sheet, SBA Form 1050, stated that a joint payee check in the amount of $446,150 was made payable to the borrower and to Cordele Production Credit Association. After depositing the full amount of the loan into the checking account, the borrower wrote a check for the entire amount of the loan to Cordele Production Credit Association.

Mr. Ronnie Everidge commented that due to the delay in the SBA loan, interim financing was obtained from the Cordele

Production Credit Association in order to produce crops for the next year. Mr. Houston commented that the borrower could have gotton interim financing to pay creditors listed in the Authorization and that this would not be a misuse of loan proceeds. We note that the borrower did have a loan balance of $938,516 as of 1 January 1978 with the Cordele Production Credit Association. Therefore, the borrower did not obtain interim financing as the SBA loan was not authorized until 18 January 1978.

Standby Agreement Not Obtained

A Standby Agreement was not obtained from the Cordele Production Credit Association as required.

By letter dated 16 March 1978, the SBA notified the borrower that prior to loan closing, the SBA had to receive satisfactory documentation that Cordele Production Credit Association would stand by on any indebtedness due it until the 1978 crops had been harvested.

By letter dated 15 March 1978, Cordele Production Credit Association notified the SBA that it would stand by for the farmers to harvest their 1978 crops. A formal Standby Agreement was not executed by Cordele Production Credit Association and, at the time the SBA loan was closed, the borrower owed Cordele Production Credit Association $1,205,379. As previously explained, the full amount of the SBA loan immediately went to pay Cordele Production Credit Association.

Mr. Kitchens, of the Cordele Production Credit Association, commented that, to the best of his knowledge, a Standby Agreement was not signed and SBA was aware that this document would not be signed and closed the loan without it. Mr. Houston, of the SBA, commented that a Standby Agreement should not have been required.

Excess Crop Yield Not Reported

The borrower did not report the actual crop yield which was in excess of the estimated crop yield for 1977 as required by the Loan Authorization.

The Loan Authorization, Paragraph 10g, required the borrower to notify the SBA if the total 1977 crop yield exceeded the estimated yield so that SBA could adjust the amount of the loan accordingly.

The actual 1977 crop yield did exceed the estimated yield; however, SBA was not notified of this. The following is a comparison of the estimated yield with the actual yield:

	CORN	SOYBEANS	COTTON	PEANUTS	TOTAL
Estimated Income	$116,499	$ 213,793	$406,757	$ 279,048	$1,016,097
Estimated Loss	110,674	192,413	366,081	251,143	920,311
Estimated Income After Disaster	5,825	21,380	40,676	27,905	95,786
Actual Income	51,478	203,798	3,754	250,482	509,512
Income (Over) or Under Estimated Income	$(45,653)	$(182,418)	$ 36,922	$(222,577)	$ (413,726)

Mr. Ronnie Everidge commented that the 1977 tax returns were submitted to the SBA so the SBA should have been aware of the actual crop loss for 1977. Mr. Houston of the SBA had no comment.

Payments From Other Federal Agencies Not Reported

The borrower did not report the payments of $34,315.20 received from another federal agency as required.

The Loan Authorization, Paragraph 10i, required that prior to any disbursement, the borrower submit the details of any and all financial assistance received from or applied for from the Farmer's Home Administration, ASCS and any other federally funded lending agency.

The borrower received $34,315.20 from the Agriculture Stabilization and Conservation Service during 1977 for the corn and cotton crop losses due to the disaster.

Neither the borrower nor the SBA had any comment.

Compensation Agreement Not Submitted

A Compensation Agreement was not submitted for the $2,617.50 fee charged by the borrower's accountant in connection with this loan.

The Settlement Sheet, SBA Form 1050, states that the borrower certifies that no fees have been or will be paid, directly or indirectly, other than those reported on SBA Forms 4 or 159, it is understood that all fees not approved by the SBA are prohibited.

The borrower's accountant charged approximately $2,617.50 for services in connection with preparing the Loan Application.

Neither the borrower nor the SBA had any comment.

Incomplete Loan Agreement

The Loan Agreement which was executed for this loan did not contain all the terms and conditions set forth in the Loan Authorization as required.

The following is a list of the conditions of the Loan Authorization which should have been included in the Loan Agreement but were not:

- If the authorized amount of the loan was in excess of the amount required to accomplish the purposes of the loan as set forth in Paragraph 5 of the Authorization, the excess amount would be reapplied on the loan.
- That the borrower provide insurance, including comprehensive coverage, with loss payable clause in favor of the SBA in such amounts and for such risks as were satisfactory to SBA.
- That the borrower purchase Federal Flood Insurance if available.
- That the borrower agree to notify the SBA if the total crop yield for 1977 exceeded the estimated yield so that the amount of the loan could be adjusted accordingly.
- That the borrower purchase and maintain hazard insurance, including fire and extended coverage.
- That the borrower would submit the details of any other federal assistance applied for or received.

Neither the borrower nor the SBA had any comment.

Inadequate Records

The borrower does not maintain adequate books and records as required.

The Loan Agreement, Paragraph 3, requires the borrower to at all times maintain proper books of account.

The borrower's records are considered inadequate because a general ledger and general journal were not maintained prior to 1979, are currently being maintained on the cash basis and were only posted through November 1979 as of the date of this audit.

Mr. East, the borrower's accountant, commented that the IRS allows farms to operate on a cash basis. Mr. Houston of the SBA commented that there will probably be an improvement in the borrower's records as they realize the need.

Financial Statements Not Submitted

The borrower has not submitted financial statements as required.

The Loan Agreement, Paragraph 3, required the borrower to submit financial statements for the period ending 31 December 1977 and annually thereafter not later than two months following the expiration of any such period.

The Loan Authorization, Paragraph 10e, required the borrower to submit annual signed and dated financial statements or copies of the Federal income tax statements in lieu thereof for the period ending 31 December 1978 and annually thereafter.

Mr. Ronnie Everidge commented that the 1977 tax returns were submitted to the SBA. Mr. Houston of the SBA had no comment.

Insurance Not Obtained

It could not be determined that hazard and flood insurance had been obtained as required.

The Loan Authorization, Paragraph 9, required the borrower to provide insurance including comprehensive coverage with loss payable clause in the favor of the SBA in amounts and for such risks as are satisfactory to the Samll Business Administration. Paragraph 10b of the Authorization required the borrower to purchase Federal Flood Insurance if it was available, and Paragraph 10h required the borrower to purchase and maintain hazard insurance, including fire and extended coverage at the maximum insurable value covering the buildings of all collateral pledged to secure the loan.

The borrower was unable to furnish any policies for either hazard or flood insurance and neither the borrower nor the SBA could provide documentation showing that Federal Flood Insurance was not available.

Regarding the hazard insurance, Mr. Houston, of the SBA, commented that if the collateral, excluding buildings, was adequate to secure the loan, the lack of hazard insurance would not be followed up. Regarding the flood insurance, Mr. Houston commented that he is still researching this matter.

Loans To Employees

The borrower has extended loans to its employees contrary to the terms of the Loan Agreement.

The Loan Agreement, Paragraph 6, prohibits the borrower from extending advances or making loans without the prior written consent of the SBA.

The borrower has extended loans to its employees and, according to the financial statements of Marcus Everidge Farms as of 30 November 1979, the accounts receivable from employees had a balance of $1,457.

The borrower had no comment. Mr. Houston, of the SBA, commented that the loans to employees would not be an issue based on the amounts of loans that had been extended.

FACT SHEET

BORROWER:	Jim Hue Jackson Floydada, Texas
SBA DISTRICT:	Lubbock
TYPE OF BUSINESS:	Farm. Produces corn, cotton and wheat
AMOUNT OF SBA DISASTER LOAN:	$53,500
TERMS OF LOAN:	Maturity date is ten years from date of loan with 3% annual interest
DISBURSEMENT DATE:	February 3, 1979
TYPE OF DISASTER:	Hail

SBA LOAN HISTORY

In September 1978, Jim Hue Jackson applied for an SBA disaster loan, claiming hail had damaged his corn, cotton and wheat crop. A loan of $53,500 was approved by the Lubbock District Office a month later. The loan was duly authorized on January 22, 1979, and disbursed in early February. Jackson signed a certification of use of proceeds stipulating that the loan proceeds would be used exclusively for debt repayment and capital for new crops.

SBA INSPECTOR GENERAL FINDINGS

Jackson received a $53,500 disaster loan from SBA after receiving a $40,080 emergency loan from the Farmers Home Administration for the identical loss. However, Jackson had properly notified SBA of the FmHA loan, but an unidentified SBA temporary loan officer approved the SBA loan, in violation of Federal law and SBA regulations.

Jackson apparently misused his loan proceeds by using $26,143.59 of funds earmarked for crop production expenses to make payments on real estate and working capital loans.

SBA ACTION

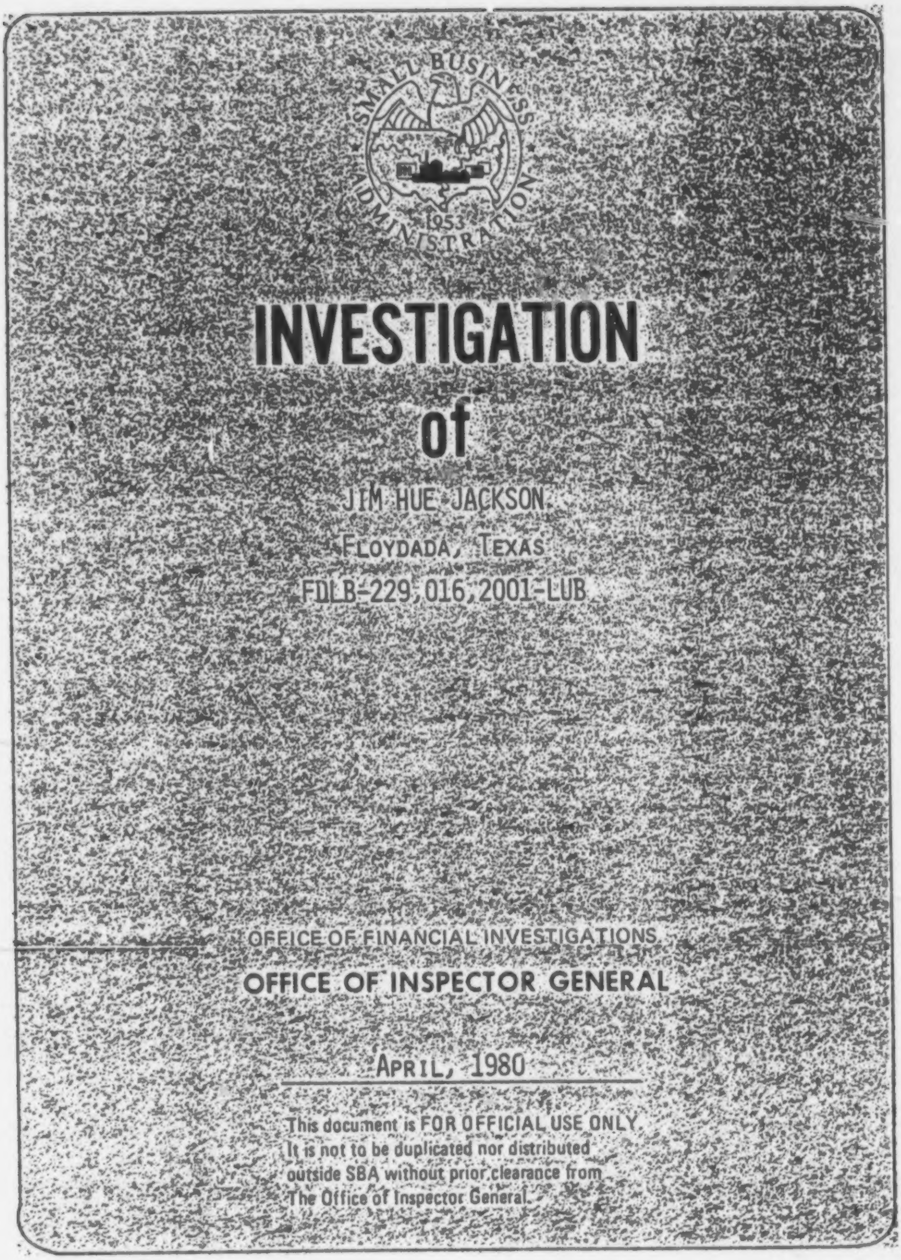
SBA referred the case of Jim Hue Jackson to the Department of Justice, which declined prosecution.

In June 1980, the SBA Lubbock District Office notified Jackson that the duplicate loan he received was in violation of the Disaster Relief Act of 1974, and demanded immediate and full repayment.

Jackson has a balance due of $33,518.47. Under an informal arrangement with the District Office, Jackson is repaying the balance in annual installments of $10,237.

BORROWER COMMENT

Jackson commented that he had properly notified SBA of his FmHA loan. He said the loan repayments were part of his overall farm expenses, and therefore, should be considered part of the production costs.



SMALL BUSINESS ADMINISTRATION
1953

INVESTIGATION
of

JIM HUE JACKSON
FLOYDADA, TEXAS
FDLB-229,016,2001-LUB

OFFICE OF FINANCIAL INVESTIGATIONS
OFFICE OF INSPECTOR GENERAL

APRIL, 1980

This document is FOR OFFICIAL USE ONLY.
It is not to be duplicated nor distributed
outside SBA without prior clearance from
The Office of Inspector General.

ATTENTION

Action taken or to be taken on the information contained in this report must be reported to the OFFICE OF INSPECTOR GENERAL, Attention: Assistant Inspector General for Investigations, within 30 days of the issue of the report.

This investigation was made in accordance with the policies and procedures contained in SOP 90 22 2.

Information contained in this report is to be disclosed only to responsible SBA personnel on a "need to know" basis. Disclosure of information to other than SBA personnel must not be made without the approval of the Inspector General and may only be done in compliance with the Freedom of Information Act (5 U.S.C. 552), and the Privacy Act of 1974, where applicable, as implemented by Agency policy, regulations, and SOP's (40 03, 40 04) and 18 U.S.C. 1905.

This report is issued by the Office of Financial Investigations, OFFICE OF INSPECTOR GENERAL.

Approved:

Marvin P. Shelton

Marvin P. Shelton, Director,
Office of Financial Investigations

Date APR 29 1980

TABLE OF CONTENTS

Page

INTRODUCTION AND SCOPE 1

SUMMARY 2

RECOMMENDATIONS 2

BACKGROUND AND LOAN INFORMATION 3

FINDINGS

Duplication of Benefits - Title 42, U.S.C., Section 5155 4

Use Of Proceeds 8

REPORT ON INVESTIGATION
OF
JIM HUE JACKSON
FLOYDADA, TEXAS
FDLB-229,016,2001-LUB

INTRODUCTION AND SCOPE

An investigation was made of Jim Hue Jackson by the Office of Financial Investigations, Office of the Inspector General, as part of its review of Disaster Loan Programs This review was initiated as a joint project by the Department of Agriculture (USDA) and the Small Business Administration (SBA) for the purpose of identifying those disaster loan recipients receiving loan benefits from both SBA and the Farmers Home Administration (FmHA) in excess of their eligibility. In addition, the purpose of this investigation and review was to verify the uses made of the loan proceeds by the borrower, and to analyze and report on SBA program management's compliance with certain internal operating procedures.

The investigation covered the period July 1978 through February 1979, as during this period the borrower applied for, received, and expended the disaster loan funds. The SBA loan file was reviewed, as were the available records of FmHA and the borrower. SBA and FmHA officials, borrower principals, and other interested third parties were contacted to obtain pertinent documentation and interviewed as deemed necessary.

SUMMARY

SBA made Mr. Jackson a farm disaster loan with knowledge of his FmHA disaster loan. Mr. Jackson had disclosed the receipt of a $40,080 loan from FmHA when he applied for the SBA loan. SBA's loan processor recommended approval of a $53,500 loan despite his awareness of the FmHA financing. This action supplied Mr. Jackson duplicate benefits for his lost production. The two loans, which totalled $93,500, exceeded Jackson's eligible loss by $40,028.

Mr. Jackson used $84,423.59, which is equivalent to all his FmHA loan and $44,343.59 of his SBA farm loan to pay debts. Mr. Jackson used $26,143.59 of SBA loan funds, which were authorized for crop production expenses, to make debt payments in addition to $18,200 which had been authorized by SBA for debt payment. Mr. Jackson used this money to make payments on real estate and working capital loans. He considered his real estate mortagages as crop expenses but he also considered his crop expenses as working capital items. He reasoned, therefore, the payments fit categories enumerated in the letter SBA used to transmit his loan checks. This letter appeared to state policy regarding use of proceeds for crop expenses at the time.

RECOMMENDATIONS

It is recommended that SBA require the borrower to return $40,028 of the loan proceeds which are in excess of his eligible loss. SBA should also inform FnHA of this action to avoid further duplications of effort.

BACKGROUND AND LOAN INFORMATION

Jim Hue Jackson began farming in Floyd County, Texas in December 1956. Before taking up farming, Jackson earned a degree in education from Texas Tech and taught at Fort Bliss in El Paso. Jackson began to buy farm land in 1966. By 1978 he owned 454 acres of land which he valued at $304,000.

In September 1978, Jackson applied for an SBA farm disaster loan. He claimed hail in May 1977, had damaged his corn, cotton, and wheat crop. The loan was approved in November 1978, to refinance debt and supply capital for new crops.

The loan was closed in February 1979. The note called for payments of $6,331 to begin in March 1979, and continue annually for ten years. After payment of the March installment, Mr. Jackson was current on his loan, and the balance due was $47,383.

After a joint review, SBA and USDA concluded Jackson might have received benefits in 1978 which were $40,028 in excess of his eligible loss. The review indicated both SBA and FmHA had made Jackson loans for his crop production loss.

FINDINGS

Duplication of Benefits - Title 42, U.S.C., Section 5155

SBA made Mr. Jackson a farm disaster loan with knowledge of his FmHA disaster loan. Mr. Jackson had disclosed the receipt of a $40,080 loan from FmHA when he applied for the SBA loan. SBA's loan processor recommended approval of a $53,500 loan despite his awareness of the FmHA financing. This action supplied Mr. Jackson duplicate benefits for his lost production. The two loans, which totalled $93,500, exceeded Jackson's eligible loss by $40,028.

The Disaster Relief Act of 1974 empowers the President to order Mr. Jackson to reimburse the Treasury for the excessive benefits awarded him. That part of the act captioned Title 42, U.S.C., Section 5155(c) states whenever it is determined that a person has received assistance for a loss that exceeds the amount of that loss, that person shall be directed to reimburse the federal government for the excess.

FmHA made Mr. Jackson a 3 percent loan of $40,080 in July 1978. The loan was made for production lost in 1977 due to hail damage. FmHA's Floyd County Supervisor had calculated Mr. Jackson's production loss at $40,080.33.

His calculation had been based on depressed yields from acreage planted in corn, cotton, and wheat. Mr. Jackson had planted 271.6 acres in corn, 226.3 acres in cotton, and 90 acres in wheat. The supervisor had estimated Mr. Jackson had lost one-third of his crop.

Mr. Jackson found out about SBA's farm disaster program sometime after he got his FmHA loan. Mr. Jackson described how he learned of the program during his interview on February 1, 1980. He learned of it from other farmers in Floydada. Everyone in the area knew about the program. As he understood it, Mr. Jackson was eligible for an SBA loan because he had suffered an economic loss due to something beyond his control.

Mr. Jackson reported the FmHA loans in SBA disaster loan package of September 1978 several times. He entered "FHA's (sic) disaster loan on his basic application in the space reserved for disclosure of previous government financing. He gave details on the loan in two supplementary forms. On his personal financial statement, Mr. Jackson listed FmHA as holder of a secured note for a $40,080 disaster loan. On an expanded schedule of debt, he listed the same information that was on the financial statement and additionally disclosed the FmHA loan had a 3 percent rate. His Crop Damage Reports did not reflect the FmHA loan as he had not yet received it when he made those reports.

During the interview, Mr. Jackson stated the he had observed his application being screened. Mr. Jackson said he had given his application to a young, short man from Boston whose name he could not recall. The man looked over the application and told him it was all right.

The loan specialist, who processed Mr. Jackson's application commented on the FmHA disaster loan in his processing report. He mentioned the loan's effect on Mr. Jackson's ability to secure his farm disaster loan. He listed the mortgage note to FmHA while commenting on Mr. Jackson's financial condition.

There was no evidence in the processor's report of contact with FmHA on Mr. Jackson's prior loan. The processor did not mention FmHA when discussing credit information. He indicated his only source of credit data had been Mr. Jackson's bank of account.

Efforts to identify the loan processor while in Lubbock were unsuccessful. Those efforts centered on trying to identify the processor from his signature. The Supervisory Loan Specialist had transferred out of the area and neither of two people consulted in Lubbock could recognize the name.

Based on the processor's recommendation, the Supervisory Loan Specialist approved a $53,500 farm disaster loan to Mr. Jackson on November 15, 1978. The amount of the loan had been determined by the processor, who set Mr. Jackson's total eligible loss at $53,552. The loan processor had determined Mr. Jackson's eligible loss based on three Crop Damage Reports used to establish eligibility. The SBA's disaster loan was based on low yields from acreage planted in corn, cotton, and wheat. When compiled, figures from these reports showed Mr. Jackson had planted 271.6 acres in corn, 226.3 acres in cotton, and 90 acres in wheat:

Farm/Crop	Corn	Cotton	Wheat
F-4	86.5		40
H-32	30.3	75.5	-
H-38	154.8	150.8	50
Acreage	271.6	226.3	90

These acreage figures matched the figures used by FmHA in their production loss estimate.

The information available confirmed the results of the joint review by SBA and FmHA. Mr. Jackson was awarded benefits in 1978, which were $40,028 greater than his highest eligible loss:

FmHA Disaster Loan	$40,080
SBA Disaster Loan	53,500
Total Loans	$93,580
SBA's Eligible Loss	(53,552)
Duplicate Benefits	$40,028

Use Of Proceeds

Mr. Jackson used $84,423.59, which is equivalent to all his FmHA loan and $44,343.59 of his SBA farm loan to pay debts. Mr. Jackson used $26,143.59 of SBA loan funds, which were authorized for crop production expenses, to make debt payments in addition to $18,200 which had been authorized by SBA for debt payment. Mr. Jackson used this money to make payments on real estate and working capital loans. He considered his real estate mortagages as crop expenses but he also considered his crop expenses as working capital items. He reasoned, therefore, the payments fit categories enumerated in the letter SBA used to transmit his loan checks. This letter appeared to state policy regarding use of proceeds for crop expenses at the time.

SBA policy which would have required Mr. Jackson to hold an agreed upon amount for new crops had expired before he got his loan. Definitive rules for using proceeds of farm disaster loans had been appended to SBA's Disaster Loan Policy Manual (SOP 50 30 1) effective in October 1977. These rules allowed farmers to use up to half their loan for outstanding obligations if they held the balance for a new crop. The Amendment establishing these rules expired in April 1978.

Mr. Jackson noted on his Farm and Home Plan that he intended to use most of the loan for debt repayment. He listed the loan as the source of funds for a $36,000 payment to PCA (Production Credit Association). FmHA's County Supervisor accepted the plan.

During the interview, Mr. Jackson disclosed that he paid PCA in December 1978. The proceeds of the FmHA loss loan were deposited in his farm account in July and he paid PCA an equivalent amount in December. Mr. Jackson produced a cancelled check for $43,790.80 which was used to pay PCA on December 29, 1978.

The use of Mr. Jackson's SBA farm disaster loan was established in early 1979. Mr. Jackson agreed to use about $18,700 for debt payment and about $34,800 for crop production expenses. Debt payments were specified in the agreement by creditor and amount to be paid. Examples of acceptable crop production expenses were listed in an instruction letter sent Mr. Jackson in February 1979.

The instruction letter listed five general categories of expense which would meet the end use terms of Mr. Jackson's loan agreement. The five categories included:

1. accounts payable for crop year
2. crop loans other than those owed the government
3. fuel, seed, and other crop expenses
4. operating and living expenses
5. notes or contracts payable, etc.

The letter transmitted four of Mr. Jackson's loan checks and the certified report form, on February 1, 1979. A fifth check for $500 was withheld as it had been made out incorrectly.

Mr. Jackson compiled his certified report on the use of the loan proceeds on February 3, 1979. Certain creditors and the amounts they had been paid were listed. Mr. Jackson revealed during the interview that he was reporting what he was going to do with the money left him when he filled out the report. Mr. Jackson added he had not made any payments at the time, but he had committed the money to the uses shown.

Mr. Jackson endorsed the checks for $18,200 made payable to him and his creditors and sent them along to the creditors. During the interview, Mr. Jackson produced documents from his creditors to verify those payments.

Proceeds of the loan earmarked for crops ($34,800) were deposited in Mr. Jackson's account with the First National Bank, Quitaque, Texas, on February 5. Mr. Jackson identified this account as his farm account. He said he put his check in the account rather than setting it aside in savings or a Certificate of Deposit. Mr. Jackson commingled the SBA loan proceeds with other funds when he deposited the check.

Mr. Jackson deposited an additional $50,025.13 in his farm account throughout the rest of February 1979. The largest deposit was $41,660.96 made up of four payments from CCC (Commodity Credit Corp.) The same day this deposit was made a check to PCA for the same amount was paid. Mr. Jackson explained he used the money he had gotten from CCC to pay PCA for a working capital loan. These two transactions were eliminated to enable a clearer determination of the farm account's activity in February 1979.

A bank statement Mr. Jackson produced for the farm account in February showed when adjusted for the wash transactions:

Balance, 2/1/79		$ 2,140.42
Deposits, 2/5 - 27/79		
From SBA	$34,800.00	
From Others (Net)	8,364.17	43,164.17
Net Available		$45,305.59
Balance, 2/28/79		(10,416.50)
Net Payments, 2/2 - 28/79		$34,889.09

There were 81 items paid during the period. Most of them were for farm operations and living expenses, but there were significant payments (as to dollar amount) for debt.

Mr. Jackson made payments on four real estate loans in February. One of the real estate payments was made to FmHA (Check No. 4352 for $13,157.00). The payment was made to cover two installments ($4,620) on a $10,000 loan and one installment ($8,537) on Mr. Jackson's $40,080 loss loan. Another real estate payment was made to the Federal Land Bank.

All the payments Mr. Jackson made in February except the one to PCA already considered were classified:

Real Estate Loans	$21,243.07	
Working Capital Loan	4,900.52	$26,143.59
Expenses & Operations		8,745.50
Total		$34,889.09

These payments were deemed a reasonable representation of how Mr. Jackson used the crop expense portion of his disaster loan.

Mr. Jackson discussed the payments during the interview. He felt the $26,143.59 he had used for his real estate and working capital loans fit within two of the general categories stated in SBA's instruction letter. He considered his real estate mortgages a crop production expense. He therefore felt the payments on real estate loans could be classified as "notes or contracts payable, etc." He considered his working capital loan a crop loan. He understood crop production expenses were working capital items.

LIST OF EXHIBITS

The original exhibits are maintained in the files of the Office of Investigations and Examinations.

1. Memo of February 1, 1980, Interview of Jim Hue Jackson with Original Notes.
2. July 27, 1978 Promissory Note, FmHA Form 441-1.
3. January 24, 1978, Certification of Disaster Losses, FmHA Form 441-22.
4. February 23, 1978, County Supervisor's Calculations and Verification of Qualifying Production Losses, FmHA Form 441-26.
5. Selected Pages of September 25, 1978, Application for Disaster Loan - Business, SBA Form 5.
6. Selected Pages of a Personal Financial Statement, SBA Form 413, as of September 25, 1978.
7. Schedule of Notes Payable submitted by Jim H. Jackson.
8. Physical Crop Damages Reports (3) with Attachments.
9. November 15, 1978, Loan Officer's Report on Business Disaster Loan, SBA Form 720.
10. Loan Approval Document, SBA Form 135.
11. July 25, 1979, Standard Review Worksheet for SBA/FmHA Emergency Loans.
12. February 23, 1978, Farm and Home Plan, FmHA Form 431-2.
13. January 22, 1979, Authorization and Loan Agreement, SBA Form 349A.
14. February 1, 1979, Letter to Mr. and Mrs. Jim Hue Jackson from Wayne Massey, Disaster Branch Counsel, SBA.
15. November 28, 1978, Request for Loan Check, SBA Form 191.
16. February 1, 1979, Memo to Jim Hue Jackson from Maxine B. Mintkenbaugh, Cashier, SBA Disaster Office.

17. February 3, 1979, Receipt for and Certification of Use of Proceeds, SBA Form 1161.

18. February 1979, Deposit Tickets for Jim Hue Jackson's account with First National Bank. Quitaque, Texas and March 12, 1980, Memo of Review.

SUPPLEMENTAL EXHIBITS

19. September 27, 1978, Memo from Jim Hue Jackson.

20. February 1, 1979, Notification of Loan Closing, SBA Form 192.

21. January 22, 1979, Note, SBA Form 147.

22. March 12, 1980, Memo of Phone Call to PMD, Lubbock, Tx.

MPS
4/30/80
File

CLEARED:

Marvin P. Shelton
Marvin P. Shelton, Director, FI

FI:OBForeman:aj 4/29/80

APR 30 1980

District Director
Lubbock, Texas

Office of Inspector General/AIG/I (80-68)

Jim Hue Jackson
Floydada, Texas

Enclosed are two copies of the investigation report on the subject. The exhibits supporting the information contained in the report are maintained in the Office of Financial Investigations.

The report indicates that SBA personnel made a farm disaster loan to Mr. Jackson, with full knowledge of his Farmers Home Administration loan. This action provided Mr. Jackson benefits which exceeded his eligible crop loss by $40,028 and is in violation of the Disastor Relief Act of 1974, Title 42 U.S.C. Section 5155.

It is recommended that SBA initiate action to recover the $40,028 which has been determined to be in excess of the 1977 crop loss and is a duplication of the amount received from Farmers Home Administration. SBA should also advise Farmers Home Administration of the action taken to avoid further duplication of benefits.

Please advise this office within 30 days of the action taken on this report and the action taken to prevent a reoccurrence of this type again.

Should you have any questions or if this office can be of further assistance, please let me know.

R. R. Reusche
Assistant Inspector General
for Investigations

Enclosures 2 9 1980

FI 2 - 57 - 3

June 5, 1980

CERTIFIED MAIL - RETURN RECEIPT REQUESTED

Mr. Jim Hue Jackson
Route 1, Box 171
Floydada, Texas 79235

Re: FDLB-229016-2001-LUB

Dear Mr. Jackson:

An inestigation report conducted by the Office of the Inspector General of the Small Business Administration reveals that you received disaster loans in 1977 from both the SBA and the Farmers Home Administration for the same eligible loss. Your receiving $40,028.00 in duplication was in violation of the Disaster Relief Act of 1974, 42 U.S.C. §§5155 and 5157(a), which provides for civil and criminal penalties for violations of the Act.

SBA hereby demands immediate repayment of the $20,028.00 which you received in excess of your eligible loss. Please contact either me or J.E. Clement within ten (10) days of the receipt of this letter to make arrangements for this repayment. If you do not respond within ten (10) days, we will take the necessary legal action to protect SBA's interest.

J. W. Gilbert
Chief, Portfolio Management

bcc: R.R. Reusche, Asst. Inspector General
for Investigations

Dallas Regional Office

[illegible]
6/12/80

U. S. SMALL BUSINESS ADMINISTRATION
712 FEDERAL OFFICE BUILDING & COURTHOUSE
1205 TEXAS AVENUE
LUBBOCK, TEXAS 79401
TELEPHONE AC-806-762-7471

June 9, 1980

R. R. Reusche
Asst. Inspector General
for Investigations
Washington, D. C. 20416

Dear Mr. Reusche:

Re: Jim Hue Jackson
FDLB-229016-2001-LUB

In accordance with your request this is to advise that we have initiated action to recover the $40,028.00 ineligible disaster farm benefit loaned to subject borrower. We are advising Farmers Home Administration of our action.

As you know the majority of the disaster farm loans were processed and disbursed in the Disaster Branch Office located at 720 Texas Avenue here in Lubbock. This operation was not under the supervision nor direction of this office but was, and still is responsible to our Dallas Regional Office.

We are also bringing this matter to the attention of our Regional Office Disaster Operation personnel. We are confident that the necessary safeguards will be established by our Regional Office to prevent recurrences of this type of offence in the future.

Sincerely,

JWGilbert
J. W. Gilbert
Acting District Director

JUN 16 1980

RECEIVED
JUL 3 1980
SBA
LUBBOCK, TEXAS

To: Clement

Route #1, Box 171
Floydada, Texas 79235
June 18, 1980

Mr. J. W. Gilbert, Chief
Portfolio Management Division
Small Business Administration
#712, 1205 Texas Avenue
Lubbock, Texas 79401

Re: FDLB-229016-2001-LLD

Dear Mr. Gilbert:

After receiving your letter of June 6 about my $40,028.00 duplication of benefits from SBA and FmHA, I met with Jim Clement, Charles Jackson and Barbara Hoffman at your office. I am unable to pay the full $40,028.00 at this time since all of my money is tied up in the farm. As I told Mr. Jackson, I was not aware that I couldn't receive a loan from both SBA and FmHA for my farming operation because of the disaster.

Mr. Jackson and Mr. Clement informed me that I would need to make some type of immediate arrangements to repay the $40,028.00 and that your approval would be necessary. I have already made regularly scheduled payments of $6,331.00 each. I request that these be applied as credit against the duplication. I can then pay out the remaining approximately $28,950.00 over the next three years at the same rate of interest as my loan. I will not be able to make these payments and my loan payments as well, so I also request that you defer my next three years regular loan payments until I have cured the duplication.

I hope this meets your approval since I have no other means of paying this duplication. Please let me know if there are any additional papers I should sign.

Sincerely,

Jim Hue Jackson

Jim Hue Jackson

[illegible]
10/7/80

U. S. SMALL BUSINESS ADMINISTRATION
712 FEDERAL OFFICE BUILDING & COURTHOUSE
1205 TEXAS AVENUE
LUBBOCK, TEXAS 79401
TELEPHONE AC-806-762-7471

October 2, 1980

R.R. Reusche
Assistant Inspector General
for Investigation
1441 "L" Street N.W.
Washington, D.C. 20416

FA2-57

RE: Jim Hue Jackson
FDLB 229016 2001LUB

Dear Mr. Reusche:

Mr. Jackson came to the Lubbock District Office and met with Jim Clemet, Charles Jackson and Barbara Hoffman and the problem of his receiving a duplication of benefits was explained to him very clearly. Mr. Jackson was very cooperative. A letter was received from Mr. Jackson on July 3, 1980, (copy attached) which stated that he was unable to repay the full duplication at this time, but would like to repay the duplication over a three year payout. Borrower's note was modified on September 26, 1980, raising his payments so that he will repay his duplication over three years.

This office feels that this is the best possible solution to this problem and will follow-up to see this is accomplised.

Sincerely,

Russell R. Berry

Russell R. Berry
District Director

DATE
FA2 -57- 6

FACT SHEET

BORROWER: Virgil H. Guerra
Roma, Texas

SBA DISTRICT: Harligen

TYPE OF BUSINESS: Ranching

AMOUNT OF SBA DISASTER LOAN: $490,000

TERMS OF LOAN: Maturity is ten years from date of loan with 3% annual interest

DISBURSEMENT DATE: April 16, 1979

TYPE OF DISASTER: Drought

SBA LOAN HISTORY

The SBA authorized a $490,000 disaster loan to Virgil H. Guerra in December 1978. Guerra's cattle operation had suffered a loss due to drought in 1977 and was eligible for a loan of up to $2,200,700. Guerra's loan application, dated December 12, 1978, requested a $490,000 loan.

SBA INSPECTOR GENERAL FINDINGS

The loan authorization and agreement required the borrower to use $490,000 for crop production. In April 1979, Guerra used $150,000 of the loan proceeds to purchase a Certificate of Deposit. As of August 31, 1981, these funds remained on deposit and were never used in the farming operation. Guerra also used a total of $163,692.20 to repay debts to private creditors and banks in violation of the loan agreement.

SBA ACTION

The SBA District Office in Harligen informed the borrower of the Inspector General findings and is currently working with the borrower to resolve these problems.

BORROWER COMMENT

Virgil H. Guerra died sometime in early 1980. His wife has assumed responsibility for the ranching operation.

The borrower claims that the four month delay in receiving their disaster loan forced them to obtain a loan from private lenders. At least $150,000 of the SBA loan proceeds were used to reduce these debts and thus the borrower believes these funds were essentially used to produce the 1979 crop. The SBA District Office agrees with this interpretation.

The borrower also claims that the funds placed into a certificate of deposit were eventually used in the farming operation. However, the borrower has been able to document only about $317,000 in crop related expenses in 1979, and the $150,000 is still on deposit.

SMALL BUSINESS ADMINISTRATION
Harlingen, Texas
and
VIRGIL H. GUERRA
Roma, Texas
LOAN NUMBER FDLB-139-593-20-09-HAR
REPORT NUMBER 7(b)-80-06-39-149

R.H. RITCHEY
ONE HUNDRED SOUTH ROYAL STREET
ALEXANDRIA VIRGINIA 22314
(703) 836 6701

6 June 1980

Director
Office of Regulatory Audits
Office of Inspector General
U.S. Small Busienss Administration
1441 L Street, N.W.; Room M-1
Washington, D.C. 20416

Dear Sir:

We have performed a limited-scope compliance audit in accordance with the terms and conditions of Contract Number SBA-1575-AUD-78 relating to the loan extended by the U.S. Small Business Administration (SBA), under the Section 7(b) Loan Program to Virgil H. Guerra, Loan Number FILB-139-593-20-09-HAR, in the amount of $490,000.

The extent of audit procedures required in performing this compliance audit is stated in the Scope of Audit section of this report.

This report is intended for use in connection with the contractual and regulatory provisions of the Authorization and Loan Agreement to which it refers and should not be used for any other purpose, including association with the financial statements of Virgil H. Guerra.

Very truly yours,

R. H. RITCHEY

By: Thomas K. Fahey
Thomas K. Fahey, CPA

TKF.lr

This is page 1 of 7 pages.

TABLE OF CONTENTS

Page

AUDIT SUMMARY 3

INTRODUCTION AND BACKGROUND 4

SCOPE OF AUDIT 5

RESULTS OF AUDIT 6

- Misuse Of Proceeds 6
- Insurance Not Obtained 6
- Financial Statements Not Submitted 7

AUDIT SUMMARY

Our examination of the loan file of the SBA's Harlingen District Office was completed on 6 June 1980. The results of that examination are as of that date. Our examination of the borrower's books and records was completed on 30 May 1980. The results of that examination are as of that date.

The findings disclosed by this audit are summarized below:

- The borrower deposited $150,000 of the loan proceeds into a long term bank account and used $163,692.20 more than authorized of the loan proceeds for debt payment.
- It could not be determined that Federal flood insurance had been obtained as required.
- The borrower has not submitted financial statements as required.

The results of this audit were discussed as applicable with Mr. Dennis Williams, accountant of Mr. Virgil H. Guerra (boorower) and Mr. Harold Sears, Harlingen District Director of the SBA. Their comments are included in this report where appropriate.

INTRODUCTION AND BACKGROUND

In accordance with the terms of Contract Number SBA-1575-AUD-78 with the Small Business Administration (SBA), a compliance audit was made of the Authorization and Loan Agreement dated 13 December 1978 which authorized a direct loan to Mr. Virgil H. Guerra in the amount of $490,000. The disaster under which this loan was authorized was a drought in 1977-1978.

The borrower was established in 1943 and is engaged in the business of cattle ranching. The business operates on a fiscal year ending 31 December and employs the accrual basis of accounting. The sole owner is Mr. Virgil H. Guerra.

SCOPE OF AUDIT

The scope of the compliance audit was limited to an examination of the books and records of Mr. Virgil H. Guerra and tests of the SBA loan files. The audit objective was to determine if Mr. Virgil H. Guerra had complied with applicable laws and regulations of the Section 7(b) Business Loan Program and the contract terms and conditions of the Authorization and Loan Agreement.

The extent of audit procedures required in performing the compliance audit was guided by the General Accounting Office publication, Standards for Audit of Governmental Organizations, Programs, Activities and Functions and the generally accepted auditing standards promulgated by the American Institute of Certified Public Accountants. However, inasmuch as the standards just mentioned apply to full-scope audits, some of the standards are not applicable to a limited-scope compliance audit. Such standards were observed where applicable.

RESULTS OF AUDIT

Based upon our audit, we believe that Mr. Virgil H. Guerra has not complied with the requirements of the SBA Authorization and Loan Agreement as stated in the following conditions:

Misuse Of Proceeds

The borrower deposited $150,000 of the loan proceeds into a long term bank account and used $163,692.20 more than authorized of the loan proceeds for debt payment.

Paragraph 3(b)1 of the Loan Authorization required $490,000 for crop production expenses.

The borrower deposited $150,000 of the loan proceeds into a long term account at 1st State Bank & Trust Co., Mission, Texas on April 17, 1979. The money was still on deposit at the audit date. The borrower used $150,042.20 of the loan proceeds to pay debt owed to the 1st State Bank of Mission, Texas and $13,650 of the loan proceeds to repay debt owed to Nancy Alexander.

Mr. Williams of the borrower commented that the borrower misunderstood types of loans to be repaid with SBA funds. Mr. Sears of the SBA said he would follow up on these matters.

Insurance Not Obtained

It could not be determined that Federal flood insurance had been obtained as required.

The Authorization and Loan Agreement, Paragraph 4(f)1, required the borrower to purchase Federal flood insurance if it was available.

The borrower could not furnish evidence that Federal flood insurance had been obtained and neither the borrower nor the SBA could provide documentation showing that such insurance was not available.

Mr. Harold Sears of the SBA stated that it was the borrower's responsibility to obtain Federal flood insurance where applicable. Mr. Sears did not believe that farmland was eligible for Federal flood insurance.

Financial Statements Not Submitted

The borrower has not submitted financial statements as required.

The Authorization and Loan Agreement, Paragraph 4c, required the borrower to submit financial statements for the period ending 31 December 1978 and semiannually thereafter no later than two months following the expiration of any such period.

The borrower failed to submit financial statements for the period ending 30 June 1979 and 31 December 1979.

Mr. Harold Sears of the SBA said that they would check on this matter.

FACT SHEET

BORROWER:	Magnolia Lane Farms Cope, South Carolina
SBA DISTRICT:	Columbia
TYPE OF BUSINESS:	Farm. Produces cotton, corn and soybeans
AMOUNT OF SBA DISASTER LOAN:	$322,000
TERMS OF LOAN:	Maturity date is ten years from date of loan with 3% annual interest on first $250,000 and 6 5/8% on remaining balance
DISBURSEMENT DATE:	December 1, 1977 and January 14, 1978
TYPE OF DISASTER:	Drought

SBA LOAN HISTORY

The SBA authorized a $322,000 loan to Tom Traywick, Vice President of Magnolia Lane Farms in October 1977. The farming operation had suffered a loss due to the drought in 1977 and was eligible for a loan of up to $322,167.

SBA INSPECTOR GENERAL FINDINGS

Traywick received a $322,000 disaster loan from SBA without notifying the agency of a $39,273.93 grant from the Agriculture Stabilization and Conservation Service for an identical loss. The loan authorization and agreement require the borrower to notify SBA of any funds received from another federally funded agency. In addition, Title 42, U.S.C. Section 5155 prohibits duplication of Federal disaster assistance.

The borrower was required to notify SBA if the actual 1977 crop yield was in excess of the estimated crop yield. Magnolia Lane Farms received their loan based on an estimated loss of $322,167. The actual loss due to drought was only $221,661. Therefore, the excess loan paid to Magnolia Lane Farms totaled $100,339. Traywick failed to notify SBA of this reduced loss so that the loan could be adjusted accordingly.

SBA ACTION

The SBA District Office in Columbia demanded repayment of the duplicate ASCS payment and the excess crop yield in October 1980. As of August 31, 1981 the District has failed to collect any of these excess payments.

BORROWER COMMENT

Traywick acknowledge that he received excess and duplicate payments and has agreed to work with the District Office to establish a repayment schedule. Traywick does, however, disagree with the amount determined to be excess crop yield. He claims that his average yield on certain crops was substantially higher than the average used to determine the amount of his SBA loan. The Columbia District Office has agreed to review this claim.

SMALL BUSINESS ADMINISTRATION
Columbia, South Carolina

and

MAGNOLIA LANE FARMS, INC.
Cope, South Carolina

LOAN NUMBER FDL-941-937-10-02-COLA
REPORT NUMBER 7(b)-80-04-64-274

R.H. RITCHEY
ONE HUNDRED SOUTH ROYAL STREET
ALEXANDRIA, VIRGINIA 22314
(703) 836-6701

18 July 1980

Director
Office of Regulatory Audits
Office of Inspector General
U.S. Small Business Administration
1441 L Street, N.W.; Room M-1
Washington, D.C. 20416

Dear Sir:

We have performed a limited-scope compliance audit in accordance with the terms and conditions of Contract Number SBA-1575-AUD-78 relating to the loan extended by the U.S. Small Business Administration (SBA), under the Section 7(b) Loan Program to Magnolia Lane Farms, Inc., Loan Number FDL-941-937-10-02-COLA, in the amount of $322,000.

The extent of audit procedures required in performing this compliance audit is stated in the Scope of Audit section of this report.

This report is intended for use in connection with the contractual and regulatory provisions of the Loan Authorization and Loan Agreement to which it refers and should not be used for any other purpose, including association with the financial statements of Magnolia Lane Farms, Inc.

Very truly yours,

R.H. RITCHEY

By:
Thomas K. Fahey, CPA
Project Manager

TKF:mb

TABLE OF CONTENTS

Page

AUDIT SUMMARY 3

INTRODUCTION AND BACKGROUND 4

SCOPE OF AUDIT 5

RESULTS OF AUDIT 6

- Payments From Another Federal Agency Not Reported 6
- Salary Limitation Violation 7
- Excess Crop Yield Not Reported 7
- Financial Statements Not Submitted 8
- Insurance Not Obtained 9

OTHER MATTERS TO BE REPORTED 10

AUDIT SUMMARY

Our examination of the loan file of the SBA's Columbia District Office was completed on 18 July 1980. The results of that examination are as of that date. Our examination of the borrower's books and records was completed on 17 July 1980. The results of that examination are as of that date.

The findings disclosed by this audit are summarized below:

- The borrower did not notify the SBA of the $39,237.93 received from the Agricultural Stabilization and Conservation Service (ASCS, for the 1977 drought disaster.
- The borrower did not limit the total annual compensation as required.
- Although required by the Loan Authorization, the borrower did not report the actual 1977 crop yield of $156,599 which was $100,556 in excess of the estimated crop yield.
- The borrower has not submitted financial statements as required.
- It could not be determined that Federal flood insurance had been obtained as required.

Additionally, we noted SBA loan servicing violations as detailed in the Other Matters To Be Reported section of this report.

The results of this audit were discussed as applicable with Mr. Tom Traywick, Jr., Vice-President-Finance of Magnolia Lane Farms, Inc. (borrower) and Mr. Bob Greenlee, Disaster Branch Manager of the SBA. Their comments are included in this report where appropriate.

INTRODUCTION AND BACKGROUND

In accordance with the terms of Contract Number SBA-1575-AUD-78 with the Small Business Administration (SBA), a compliance audit was made of the Authorization dated 29 October 1977 and Loan Agreement dated 18 November 1977 which authorized a direct loan to Magnolia Lane Farms, Inc. in the amount of $322,000. The disaster under which this loan was authorized was a drought during 1977.

The borrower was established in 1885 and is engaged in the business of farming. The business operates on a fiscal year ending 31 December and employs the accrual basis of accounting. The stockholders are Tom Traywick, Sr. owning 29 percent, Tom Traywick, Jr. owning 38 percent and James D. Traywick owning 32 percent.

Financial statements for fiscal year 1979 disclose assets of $934,884, liabilities of $907,497, capital stock of $65,400 and deficit retained earnings of $38,013. The annual sales were $173,203. Income statements for the past three years indicated a $178,936 loss in 1977, a $30,430 profit in 1978, and a $46,344 loss in 1979.

The borrower also has received payments from this Federal agency:

Agency	Amount of Payment	Date of Payment	Purpose of Payment
ASCS	$36,003.21	1978	Low Yield Cotton
ASCS	3,234.72	1978	Low Yield Corn
ASCS	176.90	1977	Wheat Deficiency

SCOPE OF AUDIT

The scope of the compliance audit was limited to an examination of the books and records of Magnolia Lane Farms, Inc. and tests of the SBA loan files. The audit objective was to determine if Magnolia Lane Farms, Inc. had complied with applicable laws and regulations of the Section 7(b) Business Loan Program and the contract terms and conditions of the Loan Authorization and Loan Agreement.

The extent of audit procedures required in performing the compliance audit was guided by the General Accounting Office publication, Standards for Audit of Governmental Organizations, Programs, Activities and Functions and the generally accepted auditing standards promulgated by the American Institute of Certified Public Accountants. However, inasmuch as the standards just mentioned apply to full-scope audits, some of the standards are not applicable to a limited-scope compliance audit. Such standards were observed where applicable.

RESULTS OF AUDIT

Based upon our audit, we believe that Magnolia Lane Farms, Inc. has not complied with the requirements of the SBA Loan Authorization and Loan Agreement as stated in the following conditions:

Payments From Another Federal Agency Not Reported

The borrower did not notify the SBA of the $39,237.93 received from the Agricultural Stabilization and Conservation Service (ASCS) for the 1977 drought disaster.

Page 3 of the Loan Authorization required that prior to any disbursement of the SBA loan, the borrower notify the SBA of any and all financial assistance received from or applied for from any federally funded agency.

The borrower received $39,237.93 from ASCS, a federally funded agency, for the loss sustained on its corn and cotton crops. The estimated amount of the loss on these crops was the basis for determining the amount the borrower was eligible to borrow under the SBA disaster loan program. Had the borrower notified the SBA of the payments received from ASCS, the amount of the SBA loan may have been adjusted accordingly.

Mr. Traywick of the borrower commented that he was not aware of this requirement. Mr. Greenlee of the SBA stated that they will follow up on this matter.

Salary Limitation Violation

The borrower did not limit the total annual compensation as required.

The Loan Agreement, Paragraph 7, required the three key employees, Thomas Traywick, Sr., Thomas Traywick, Jr., and James Traywick to limit their annual compensation to $15,000 each.

The borrower paid each of these key employees $18,250 in 1977 and $18,000 in 1978 and 1979.

Mr. Traywick of the borrower commented that he was not aware of this requirement and that this should be adjusted for a cost of living increase. Mr. Greenlee of the SBA commented that the borrower should adhere to this requirement.

Excess Crop Yield Not Reported

Although required by the Loan Authorization, the borrower did not report the actual 1977 crop yield of $156,599 which was $100,556 in excess of the estimated crop yield.

Page 3 of the Loan Authorization required the borrower to notify the SBA if the total 1977 yield of each crop exceeded the estimated yield so that the SBA could adjust the amount of the loan accordingly.

The following is a comparison of the estimated and actual crop yields of the borrower for its 1977 crop:

	Cotton	Soybeans	Corn	Total
Estimated Income Prior to Disaster	$196,535	$60,746	$120,929	$378,210
Estimated Loss Due to Disaster	176,882	36,448	108,837	322,167
Estimated Income After the Disaster	19,653	24,298	12,092	56,043
Actual Income Per Borrower's Books	33,923	79,620	43,056	156,599
Actual Income Over Estimated Income	$ 14,270	$55,322	$ 30,964	$100,556

Thus the borrower's actual loss from the disaster was only $221,611 and not $322,167 as estimated.

Mr. Traywick of the borrower commented that he was not aware of this requirement. Mr. Greenlee of the SBA stated that they will follow up on this matter.

Financial Statements Not Submitted

The borrower has not submitted financial statements as required.

The Loan Agreement, Paragraph 3, required the borrower to submit financial statements for the period ending 1 December 1978 and annually thereafter no later than two months following the expiration of any such period.

The borrower prepares annual financial statements but failed to submit these to the SBA.

Mr. Traywick of the borrower commented that they will be sending these statements. Mr. Greenlee of the SBA stated that they should be submitting these statements.

Insurance Not Obtained

It could not be determined that Federal flood insurance had been obtained as required.

The Loan Authorization, Page 3, required the borrower to purchase Federal flood insurance if it was available.

The borrower could not furnish evidence that Federal flood insurance had been obtained and neither the borrower nor the SBA could provide documentation showing that such insurance was not available.

Mr. Greenlee of the SBA commented that unimproved farm land is not subject to flood insurance and that flood maps were not available.

OTHER MATTERS TO BE REPORTED

SBA Loan Servicing Violations

The SBA did not service or process this loan in accordance with its Standard Operating Procedures.

The Columbia District office failed to perform the following as required:

- Opinion of SBA counsel was not obtained on the first disbursement required by SOP 50-30 and the Authorization.

Mr. Greenlee of the SBA commented that this was an oversight.

R.H. RITCHEY
ONE HUNDRED SOUTH ROYAL STREET
ALEXANDRIA, VIRGINIA 22314
(703) 836-8701

php

8/4/80
Date

Mr. Dennis G. Lund
Project Officer
Office of Regulatory Audits
Office of Inspector General
U.S. Small Business Administration
1441 L Street, N.W.; Room M-1
Washington, D.C. 20416

Dear Mr. Lund:

By signature below, please acknowledge receipt of the workpapers and five copies of the audit report for the following borrowers:

Magnolia Lane Farm
Name

7(b)-80-04-64-274
Report Number

Thomas K. Fahey, CPA

To: Mr. Thomas K. Fahey
R. H. RITCHEY

Receipt acknowledged for the above stated audit report for the U.S. Small Business Administration, Office of Regulatory audits.

Name

8/5/80
Date

FACT SHEET

BORROWER:	Tilco Farm, Inc. Mayesville, South Carolina.
SBA DISTRICT:	Columbia
TYPE OF BUSINESS:	Farm. Produces cotton, soybeans and corn
AMOUNT OF SBA DISASTER LOAN:	$456,300
TERMS OF LOAN:	Maturity is ten years from date of loan with interest of 3% on first $250,000 and 6 5/8% on remaining balance
DISBURSEMENT DATE:	December 1, 1977 and January 14, 1978
TYPE OF DISASTER:	Drought

SBA LOAN HISTORY

Robert James Tiller, operator and sole owner of Tilco Farm, Inc. applied for a $456,300 SBA Disaster Loan on September 23, 1977. Tilco Farm had suffered a loss which totaled $456,305 due to drought in 1977. The SBA approved the application and authorized a $456,300 loan to Tilco Farm on November 18, 1977. Mr. Tiller received the proceeds in two installments on December 1, 1977 and January 14, 1978.

SBA INSPECTOR GENERAL FINDINGS

Tilco Farm received a $456,300 Disaster Loan from SBA and failed to notify SBA of a $40,823 grant received from the Agriculture Stabilization and Conservation Service (ASCS) for an identical loss. The borrower violated the loan authorization and agreement which stipulated that they must inform SBA of any funds received from another federally funded agency so that the amount of the SBA loan could be reduced accordingly. In addition, Title 42, U.S.C. Section 5155 prohibits duplication of Federal disaster assistance.

Tilco Farm received an SBA loan based on an estimated crop loss of $456,308. The farms actual loss due to the disaster was only $184,398, therefore the borrower received a loan which was $271,910 in excess of his actual loss. The loan authorization and agreement require the borrower to notify SBA if the estimated loss is greater than the actual loss so that the loan may be adjusted accordingly. Robert Tiller failed to notify SBA of this increase in his actual 1977 crop yield.

SBA ACTION

The SBA Columbia District Office contacted the borrower and demanded repayment of the excess loan proceeds and duplicate ASCS grant in October 1980. As of August 31, 1981 the district has failed to collect any of these excess funds.

BORROWER COMMENTS

Robert Tiller acknowledged that he received an excess loan and a duplicate ASCS payment. Tiller has expressed a willingness to repay these funds to SBA. He explained that he did not realize he was violating the SBA regulations but that if he had done so he would correct the error.

SMALL BUSINESS ADMINISTRATION

Columbia, South Carolina

and

TILCO FARM, INC.

Mayesville, South Carolina

LOAN NUMBER DL-937-850-10-07-COLA

REPORT NUMBER 7(b)-80-04-64-266

R.H. RITCHEY
ONE HUNDRED SOUTH ROYAL STREET
ALEXANDRIA, VIRGINIA 22314
(703) 836-6701

28 August 1980

Director
Office of Regulatory Audits
Office of Inspector General
U.S. Small Business Administration
1441 L Street, N.W.; Room M-1
Washington, D.C. 20416

Dear Sir:

We have performed a limited-scope compliance audit in accordance with the terms and conditions of Contract Number SBA-1575-AUD-78 relating to the loan extended by the U.S. Small Business Administration (SBA), under the Section 7(b) Loan Program to Tilco Farm, Inc., Loan Number DL-937-850-10-07-COLA, in the amount of $456,300.

The extent of audit procedures required in performing this compliance audit is stated in the Scope of Audit section of this report.

This report is intended for use in connection with the contractual and regulatory provisions of the Loan Authorization and Loan Agreement to which it refers and should not be used for any other purpose, including association with the financial statements of Tilco Farm, Inc.

Very truly yours,

R. H. RITCHEY

By: Thomas K Fahey
Thomas K. Fahey, CPA
Project Manager

TKF:lr

This is page 1 of 8 pages.

TABLE OF CONTENTS

Page

AUDIT SUMMARY 3

INTRODUCTION AND BACKGROUND 4

SCOPE OF AUDIT 5

RESULTS OF AUDIT 6

- Excess Crop Yield Not Reported 6
- Payment From Another Federal Agency Not Reported 7
- Insurance Not Obtained 8

AUDIT SUMMARY

Our examination of the loan file of the SBA's Columbia District Office was completed on 28 August 1980. The results of that examination are as of that date. Our examination of the borrower's books and records was completed on 15 August 1980. The results of that examination are as of that date.

The findings disclosed by this audit are summarized below:

- Although required by the Authorization, the borrower did not report the actual 1977 crop yield of $459,425 which was $271,910 in excess of the estimated crop yield.
- The borrower did not notify the SBA of the $40,823.68 received from the Agricultural Stabilization and Conservation Service (ASCS) for the 1977 drought disaster.
- It could not be determined that Federal flood insurance had been obtained as required.

The results of this audit were discussed as applicable with Mr. James King, CPA, accountant of Tilco Farm, Inc. (borrower) and Mr. Robert Greenlee, Jr., Disaster Branch Manager of the SBA. Their comments are included in this report where appropriate.

INTRODUCTION AND BACKGROUND

In accordance with the terms of Contract Number SBA-1575-AUD-78 with the Small Business Administration (SBA), a compliance audit was made of the Authorization dated 18 November 1977 and Loan Agreement dated 23 January 1978 which authorized a direct loan to Tilco Farm, Inc. in the amount of $456,300. The disaster under which this loan was authorized as a drought occurring in the spring and summer of 1977.

The borrower was established in 1972 and is engaged in the business of producing cotton, soybeans and corn. The business operates on a fiscal year ending 28 February and employs the cash basis of accounting. The sole owner is Robert James Tiller.

Financial statements for fiscal year 1980 disclose assets of $828,845, liabilities of $614,051, and owner's equity of $214,794. The total income for FY 1980 was $1,032,746. Income statements indicated a $93,755 profit in 1980 and a $168,960 loss for the 9 month period ending November 1978.

The borrower also has received a payment from this Federal agency:

Agency	Amount of Payment	Date of Payment	Purpose of Payment
ASCS	$40,823.68	1977	cotton deficiency

INTENTIONAL
BLANK

SCOPE OF AUDIT

The scope of the compliance audit was limited to an examination of the books and records of Tilco Farm, Inc. and tests of the SBA loan files. The audit objective was to determine if Tilco Farms, Inc. had complied with applicable laws and regulations of the Section 7(b) Business Loan Program and the contract terms and conditions of the Authorization and Loan Agreement.

The extent of audit procedures required in performing the compliance audit was guided by the General Accounting Office publication, Standards for Audit of Governmental Organizations, Programs, Activities and Functions and the generally accepted auditing standards promulgated by the American Institute of Certified Public Accountants. However, inasmuch as the standards just mentioned apply to full-scope audits, some of the standards are not applicable to a limited-scope compliance audit. Such standards were observed where applicable.

RESULTS OF AUDIT

Based upon our audit, we believe that Tilco Farm, Inc. has not complied with the requirements of the SBA Loan Authorization and Loan Agreement as stated in the following conditions:

Excess Crop Yield Not Reported

Although required by the Loan Authorization, the borrower did not report the actual 1977 crop yield of $459,425 which was $271,910 in excess of the estimated crop yield.

The Authorization required the borrower to notify the SBA if the total 1977 yield of each crop exceeded the estimated yield so that the SBA could adjust the amount of the loan accordingly.

The following is a comparison of the estimated and actual crop yields of the borrower for its 1977 crop:

	Corn	Soybeans	Cotton	Total
Estimated Income Prior to Disaster	$ 74,030	$ 48,302	$521,491	$643,823
Estimated Loss Due to Disaster	22,209	16,906	417,193	456,308
Estimated Income After the Disaster	51,821	31,396	104,298	187,515
Actual Income Per Borrower's Books	103,337	117,302	238,786	459,425
Actual Income Over or (Under) Estimated Income	$ 51,516	$ 85,906	$134,488	$271,910

Thus the borrower's actual loss from the disaster was only $184,398 and not $456,308 as estimated.

Mr. King, CPA, accountant for the borrower, did not comment on this finding. Mr. Greenlee, Jr., of the SBA commented that he will look into the matter.

Payment From Another Federal Agency Not Reported

The borrower did not notify the SBA of the $40,823.68 received from the Agricultural Stabilization and Conservation Service (ASCS) for the 1977 drought disaster.

The Authorization required that prior to any disbursement of the SBA loan, the borrower notify the SBA of any and all financial assistance received from or applied for from any federally funded agency.

The borrower received $40,823.68 from ASCS, a federally funded agency, for the loss sustained on its 1977 cotton crop. The estimated amount of the loss on this crop was the basis for determining the amount the borrower was eligible to borrow under the SBA disaster loan program. Had the borrower notified the SBA of the payment received from ASCS, the amount of the SBA loan may have been adjusted accordingly.

Mr. King, CPA, accountant for the borrower, did not comment on this finding. Mr. Greenlee, Jr., of the SBA commented that the SBA will attempt to settle the problem.

Insurance Not Obtained

It could not be determined that Federal flood insurance had been obtained as required.

The Authorization required the borrower to purchase Federal flood insurance if it was available.

The borrower could not furnish evidence that Federal flood insurance had been obtained and neither the borrower nor the SBA could provide documentation showing that such insurance was not available.

Mr. King, CPA, accountant for the borrower, commented that the flood zone is as yet undetermined. Mr. Greenlee of the SBA commented that the time and resources of the SBA are too limited to investigate each piece of property. In addition, no Federal flood insurance is required on unimproved land.

This is page 8 of 8 pages.

U.S. Small Business Administration

SETTLEMENT SHEET

o: Small Business Administration (SBA)	SBA Loan Number DLB 936313 10 00 A1.
	Loan Authorization Date November 25, 1977
. Complete on initial report or as terms are modified, Amount of Note $ 194,900.00 Date of Note: 1/5/78 Lender Computes interest on ______ day basis	Borrower (Name) Thomas Earl Davis Route # 4 Blakely, Georgia 31723
. Disbursement - Report initial and each subsequent amount immediately. Amount disbursed (Itemized below): $97,450.00 Date disbursed: 1/5/78	Lender (Name and Address - Include ZIP Code) Small Business Administration

For the purpose of inducing SBA, directly or indirectly to participate in any way in this loan the Borrower, with knowledge of the provisions of 18 U.S.C. 1001 and 15 U.S.C. 645 which provide certain criminal penalties for making false statements, acknowledges receipt of $ 97,450 00 on 1/5/78 and certifies (1) that the proceeds of this disbursement will be and all previous disbursements have been used, in accordance with the Loan Authorization, (2) that there has been no substantial adverse change in the financial condition, organization, operations, or fixed assets, since the application for this loan was filed and/or subsequent to the previous disbursement, and (3) that there are no liens or encumbrances against the real or personal property securing said loan except those referred to and disclosed in the application for this loan.

Lender certifies that disbursement of the loan proceeds was made and the loan proceeds were used as set forth below and in accordance with the provisions of the Loan Authorization by issuance of joint payee checks as detailed below, except checks for cash operating capital or as otherwise directed by the Loan Authorization, and that construction paid for with loan proceeds as listed below has been completed. (Any deviation from the Loan Authorization must be authorized in writing by S' or to expenditure of the loan funds.)

See Paragraph 5, of Authorization "Use of Proceeds."

Applicable subparagraph	Name of Payee	Amount of Payment	Date of Payment	Purpose
a.	Thomas Earl Davis & Southwest Georgia Production Credit Association, Colquitt, Georgia	$48,725.00	1/5/78	Debt Payment
a.	Thomas Earl Davis & The Peoples Bank, Colquitt, Georgia	$48,725.00	1/5/78	Debt Payment

To further induce SBA to participate in the loan, Lender certifies that neither the Lender nor its officers, agents, affiliates or attorneys, have or will charge, or receive, directly or indirectly, any bonus, fee, commission, or other payment or benefit, or require a compensating balance, Certificate of Deposit or other security in connection with making or servicing of this loan except as may be specifically permitted by the Loan Authorization, SBA regulations or the SBA Form 750 "Guaranty Agreeme

Lender and Borrower hereby certify that no fees have been or will be paid, directly or indirectly, other than those reported on SBA Forms 4 or 159 "Compensation Agreement." It is understood that all fees not approved by SBA are prohibited.

Lender

____

By ______________________

Date ______________________

Borrower

Thomas Earl Davis

Signed Thomas Earl Davis (L.S.)

Date 1/5/78

This Certification must be signed and returned to the SBA immediately after each disbursement. If a large number of checks, itemize on separate sheets, sign and attach hereto.

Whoever makes any statement knowing it to be false, or whoever willfully overvalues any security, for the purpose of obtaining for himself or for an applicant any loan, or extension thereof by renewal, deferment of action, or otherwise, or the acceptance, release, or substitution of security therefor, or for the purpose of influencing in any way the action of the SBA, or for the purpose of obtaining money, property, or anything of value, under the Small Business Act, as amended, shall be punished under the provisions of 18 U.S.C. 1001 and/or 15 U.S.C. 645, by fine of not more than $5,000 or by imprisonment for not more than two years, or both.

SBA Review By Dennis Barnes	Title DISASTER ATTORNEY	Date 2/24/78

A FORM 1050 (11-73) REF SOP 70 50 PREVIOUS EDITIONS & SBA FORM 740 ARE OBSOLETE

WHITE TO SBA, YELLOW TO LENDER, PINK TO BORRO

OWNER'S AFFIDAVIT

ATE OF GEORGIA

COUNTY OF DOUGHERTY

BEFORE me came in person THOMAS EARL DAVIS, who having been duly sworn on oath states as follows:

The undersigned is the owner of all that tract or parcel of land lying and being in EARLY County, being more fully described in a security deed in favor of SBA dated the 5 day of JANUARY, 1978, recorded in Deed Book N/A, Page N/A, of the Public Records of N/A County, Georgia.

Deponent further states that there are no unpaid or unsatisfied security deeds, mortgages, claims of lien, special assessments for sewage or street improvements or taxes which could constitute a lien against said land, except:

1ST LIEN TO FEDERAL LAND BANK

2ND " " PCA

Deponent further states that no person other than the Deponent, or those persons claiming under and through the Deponent, claims the right to possession of said property, and;

That there is no outstanding indebtedness for equipment, appliances or other fixtures attached to said property, and;

That the lines and corners of said property are clearly marked, and ther are no disputes concerning the location of said lines and corners, and;

t there are no pending suits, proceedings, judgements, bankruptcies, as or executions against said owner either in the aforesaid County or any other County in the State of Georgia, and;

That no improvements or repairs have been made on the above described property during the three months immediately preceding this date, and th are no outstanding bills incurred for labor and materials used in making improvements or repairs on said premises, or for services of architects, surveyors or engineers incurred in connection therewith.

Sworn to and subscribed before me

this 1/5/78

Thomas Earl Davis (L.S

THOMAS EARL DAVIS

(L.S.

Jane Jay

Notary Public

My Commission expires: 7/14/81

UNITED STATES GOVERNMENT
SMALL BUSINESS ADMINISTRATION

DISASTER BUSINESS LOAN
DIRECT
(F) DL-B 948977 10 10-COLA

AUTHORIZATION

There is hereby authorized a Loan by this Administration (pursuant to Section 7(b) of the Small Business Act, as amended) to R. V. SEGARS COMPANY, INC. of Rt. 1, Oswego, South Carolina 29121 (hereinafter called "Borrower"), on Borrower's application dated December 30, 1977, in the amount and upon the conditions as follows:

D AMOUNT: Four Hundred Eighty Five Thousand Nine Hundred and no/100 ($485,900.00) Dollars

NOTE PAYABLE:

D With interest at the rate of Three percent (3%) per annum on $250,000.00 and Six and Five Eighths percent (6 5/8%) per annum on $235,900.00 in installments of $46,235.00 including principal and interest with first payment due December 1, 1978 and annually thereafter with remaining balance of interest and principal to be paid in full December 1, 1992.

Interest shall be computed at the rate of 3% per annum on the first $250,000.00 of physical disaster loss funds disbursed and at the rate of 6-5/8% on additional physical disaster loss funds disbursed. Repayment of principal shall be first applied to reduction of the principal bearing interest at 3% and when that principal is fully paid to the reduction of principal bearing interest at 6-5/8%.

COLLATERAL:

D Mortgage on real estate described in Exhibit A & B attached hereto with best lien position available. Prior mortgages known to SBA shall not have "dragnet", "open end" or "subsequent loan" clauses or they shall be waived as to this loan except for Production Credit Association.

D Best security interest position available in all equipment described in Exhibit A attached hereto, with replacements thereof.

GUARANTY:

D Guarantee on SBA Form 148 of R. V. Segars, Jr.

USE OF PROCEEDS OF LOAN:

PHYSICAL LOSS:

Approximately $242,950.00 (but not to exceed fifty percent (50%) of eligible loan amount) to be used as follows:

NOTES PAYABLE: $242,950.00

National Bank of South Carolina	$242,950.00

Approximately $242,950.00 for crop replacement. These funds will be disbursed when Borrower begins his next crop, as evidenced by borrower's RECEIPT FOR AND CERTIFICATION OF USE OF PROCEEDS.

Excess unused sums shall be cancelled or disbursed and applied to the loan in inverse order of maturity.

Prior to actual disbursement of fund by SBA, SBA reserves the right to amend the authorized use of funds, to postpone actual disbursement, or to reduce the size of the loan or otherwise unilaterally amend this authorization to comply with amendments or modification in Law, Regulation or SBA policy.

LOAN AGREEMENT:

SBA Form 153 which shall incorporate the terms of this Authorization.

COUNSEL'S OPINION:

On both the first and final disbursements, opinion of SBA Counsel on SBA Form 145 shall be executed.

OTHER CONDITIONS:

When any location(s) of business or of any collateral are designated, fall within boundaries of special flood hazard areas, and Federal Flood Insurance becomes available, borrower will purchase and maintain such insurance in amounts and coverages equal to the lesser of (a) sum of all interests listed as loss payees (b) highest insurable value or (c) upper limits of available coverage. Borrower will not be eligible for any future flood disaster assistance if this flood insurance is not maintained.

Borrower agrees that he (it) will retain receipts and other records of USE OF PROCEEDS for three (3) years after final disbursement for possible SBA audit.

Borrower agrees to notify SBA of any funds received from any source, government or private, which could be considered as reimbursement for losses suffered due to the disaster.

Borrower agrees to notify SBA if the actual yields on the damaged crops exceed the following estimated yields:

TYPE OF CROP	ESTIMATED YIELD
Cotton (Sumter Co.)	144 lbs per acre
Corn (Sumter Co.)	17.4 Bu per acre
Soybeans (Sumter Co.)	8.2 Bu per acre
Cotton (Lee Co.)	223.04 lbs per acre
Corn (Lee Co.)	18.26 Bu per acre
Soybeans (Lee Co.)	8.82 Bu per acre

Borrower will maintain financial records and accounts sufficient to prepare and Borrower will prepare and furnish to SBA annual financial statements consisting of Balance Sheet and Profit and Loss Statement in form satisfactory to SBA beginning with period ending December 31, 1978 and annually thereafter.

A-1 ②

Applicant's representatives (as accountant and attorney) and applicant shall submit "Compensation Agreement", SBA Form 159, detailing hours worked for applicant, work performed and basis of fee charged.

Borrower shall post and maintain SBA Form 722, "Equal Opportunity Poster" where it will be clearly visible to employees, applicants and the general public.

NO ADVERSE CHANGE:

Prior to the first disbursement, and to each subsequent disbursement on account of the Loan, Disaster Branch Manager shall be in receipt of evidence satisfactory to him in his sole discretion that there has been no adverse change since the date of the Application, or since any of the preceding disbursements, or that since the date of such Application or of any such disbursement, no facts or circumstances have become known or have arisen with respect to the organization, operation, business prospects, fixed or other property, personnel, or in the financial or any other condition of Borrower, which would warrant withholding or not making any such disbursement or any further disbursement.

SUCH OTHER CONDITIONS as Disaster Branch Manager or SBA Counsel may impose pursuant to outstanding general requirements and instruction of this Administration.

DISBURSEMENT of the Loan shall be made by SBA Counsel located at Columbia, South Carolina, from time to time in the discretion of said SBA Counsel against all the aforesaid collateral in accordance with the requirements of this Authorization and the applicable general requirements and instructions of this Administration, provided, however, that no disbursement shall be made later than twelve (12) months from date of this Authorization.

The foregoing Authorization was duly approved by the
Small Business Administration on March 11, 1978.

A. VERNON WEAVER
Administrator

By: C. M. McKenzie
C. M. McKenzie
Disaster Branch Manager
SMALL BUSINESS ADMINISTRATION

SBA LOAN NO.
(F) DL-B 948977 10 10-COLA

SMALL BUSINESS ADMINISTRATION

LOAN AGREEMENT

To induce SMALL BUSINESS ADMINISTRATION
(SBA or other lending institution)

(hereinafter called "Lender") to make, and in consideration of the making of a loan or any part thereof (hereinafter called "Loan") to

R. V. SEGARS COMPANY, INC.

(hereinafter called "Borrower"), approved by Authorization of SBA dated March 11 1978 (which Authorization and all amendments thereof, heretofore and hereafter issued, are hereinafter collectively called "Authorization") Borrower hereby represents and warrants to, and agrees with, Lender, its successors or assigns, and each of them that:

1. *Use of Proceeds.*—Borrower will use the proceeds of the Loan for the purposes set forth in the Authorization.

2. *Reimbursable Expenses.*—Borrower will, on demand, reimburse Lender for any and all expenses incurred, or which may be hereafter incurred, by Lender from time to time in connection with or by reason of Borrower's application for, and the making and administration of the Loan.

3. *Books, Records, and Reports.*—Borrower will at all times keep proper books of account in a manner satisfactory to Lender and SBA. Borrower hereby authorizes Lender or SBA to make or cause to be made, at Borrower's expense and in such manner and at such times as Lender or SBA may require, (a) inspections and audits of any books, records and papers in the custody or control of Borrower or others, relating to Borrower's financial or business conditions, including the making of copies thereof and extracts therefrom, and (b) inspections and appraisals of any of Borrower's assets. Borrower will furnish to Lender as of the Twelve month period ending December 31, 1978 and Annually thereafter (no later than 2 months following the expiration of any such period) and at such other times and in such form as Lender may prescribe, Borrower's financial and operating statements, including schedules showing all compensation then being paid by Borrower to all officers, directors, holders of 10% or more of Borrower's capital stock, partners or proprietors. Borrower hereby authorizes all Federal, State and municipal authorities (a) to furnish reports of examinations, records, and other information relating to the conditions and affairs of Borrower and any desired information from reports, returns, files, and records of such authorities upon request therefor by Lender or SBA; and (b) to permit representative of Lender or SBA to have full access from time to time to, and make copies of and extracts from, any and all reports or returns by, or with respect to Borrower, and all reports of examiners or other information concerning Borrower contained in the files and records of such authorities.

4. *Fixed Asset Limitation.*—Borrower will not in any fiscal year make or incur any obligation to make any expenditures for the acquisition of or improvement or addition to any real property, machinery, equipment, fixtures or furniture, by purchase or by lease purchase agreement or option, the aggregate cost or annual rental of which is in excess of $______, exclusive of such fixed assets to be acquired with the proceeds of the Loan or any part thereof.

5. *Payment of Life Insurance Premiums.*—Borrower agrees, with respect to any life insurance assigned or which may be required to be assigned or pledged as collateral for the Loan, that it will at all times, while said Loan or any part thereof remains unpaid, promptly pay or cause to be paid any and all premiums or charges due or payable upon or on account of any such policy or policies so assigned or pledged, and will at all times, while said Loan or any part thereof remains unpaid, maintain and continue such policy or policies in full force and effect, and will take any and all action necessary or required by Lender or by the company or companies issuing any such policy or policies to complete, perfect and preserve the rights of the insured or beneficiary to the end that any such policy or policies will not lapse or be subject to any claim whatsoever. In the event Borrower fails to pay any such premiums when due, Lender may advance the amount necessary to pay such premiums and add the amount so advanced to the principal indebtedness owing on account of the Loan.

6. *Distributions and Compensation.*—Borrower will not, without the prior written consent of Lender or SBA (a) if Borrower is a corporation, declare or pay any dividend or make any distribution upon its capital stock, or purchase or retire any of its capital stock, or consolidate, or merge with any other company, or give any preferential treatment, make any advance, directly or indirectly, by way of loan, gift, bonus, or otherwise, to any company directly or indirectly controlling or affiliated with or controlled by Borrower, or any other company, or to any officer, director, or employee of Borrower, or of any such company, (b) if Borrower is a partnership or individual, make any distribution of assets of the business of Borrower, other than reasonable compensation for services, or give any preferential treatment, make any advance, directly or indirectly, by way of loan, gift, bonus, or otherwise, to any partner or any of its employees, or to any company directly or indirectly controlling or affiliated with or controlled by Borrower, or any other company, or (c) increase the compensation of any person above the respective amounts shown for such person in paragraph 7 hereof, or create any new position for any such person; provided that Borrower may fill, through promotion, new employment or otherwise, a vacancy in any of the offices or positions shown in said paragraph 7 at not more than the rate of compensation for such office or position set forth therein. If any company directly or indirectly controlling, affiliated with, or controlled by Borrower shall increase the compensation paid by it to any person so that the aggregate amount payable to such person from all such sources exceeds the respective amount shown in said paragraph 7, the compensation payable to such person by Borrower will be forthwith correspondingly reduced and immediate notice thereof given to Lender by Borrower.

7. *Compensation.*—Borrower will limit the total annual compensation (including salaries, withdrawals, fees, bonuses, commissions, drawing accounts and other payments whether direct or indirect, in money, or otherwise) of all officers, stockholders, directors, partners, proprietors or others named herein to the following named persons in the amount set opposite each respective name:

Name	Position	Amount

and, if permitted by the Authorization, such additional amount to each said party as may be necessary to pay his income taxes on said compensation computed on the basis that such compensation is his only income, provided that such additional amount shall not exceed the net tax payable by each said party. Borrower, if a corporation, may, upon prior written notice to Lender of its intention so to do, accrue on its books or pay additional compensation to any person named herein provided that, if paid, such additional compensation is immediately loaned to Borrower by such person for the use of Borrower until the Loan is paid in full.

8. *Fees and Commissions.*—Borrower has not, directly or indirectly, paid or agreed to pay, or procured any person, partnership, association or corporation, to pay or agree to pay, and will not directly or indirectly pay or agree to pay, or procure any person, partnership, association, or corporation to pay or agree to pay, (a) any bonus, fee, commission or other compensation in any form in connection with the application for or the obtaining of the Loan; or (b) any charge or expense, in any form, in connection with said application or Loan, for the services of any kind of an appraiser, accountant, attorney, or any other party whatever, whether a person, partnership, association or corporation, whether for evidencing matters required to be presented with reference to said application or Loan, or for services in any manner connected with said

application or Loan, except as permitted in writing by Lender. Borrower hereby certifies to Lender that: The names of all attorneys, accountants, appraisers, agents, and all other parties (whether individuals, partnerships, associations or corporations), engaged by or on behalf of Borrower (whether on a salary, retainer or fee or other basis and regardless of the amount of compensation) for the purpose of rendering professional or other services to Borrower in connection with the application of Borrower for the Loan, or with the making of the Loan or for the purpose of expediting said application or the Loan; and all fees or other charges or compensation paid or to be paid therefor, whether in money, property, services or otherwise, by or for the account of Borrower, together with a description of such services rendered, or to be rendered, are set forth in the application for the Loan and no such attorney, accountant, appraiser, agent or other party has been engaged by or on behalf of Borrower for the purposes, or any of them, referred to in this paragraph, since the date of said application except the following: (if none, so state)

Name and Address (Include ZIP Code)	Description of Services	Total Fees or Other Compensation To Be Paid	Total Fees or Other Compensation Already Paid
Lee, Moise, Myers & Erter	Preparation of loan documents	$200.00	None

9. Borrower will not, without the prior written consent of Lender and SBA create, assume or otherwise suffer to exist any mortgage, pledge or other incumbrance upon any of the real or tangible personal property of the Undersigned, whether now owned or hereafter acquired, except (a) liens for taxes or other governmental charges not delinquent being contested in good faith, or (b) purchase money liens upon property acquired after the date of the Note, and other liens upon such p at the time of the acquisition thereof.

10. Other provisions.

Au The terms and conditions of SBA Authorization dated March 11, 1978, a copy of which is attached hereto, are incorporated herein by reference and govern the disbursement and management of this loan.

11. *Parties Affected.*—This Agreement shall be binding upon Borrower and Borrower's successors and assigns and shall inure to the benefit of Lender and its successors and assigns.

IN WITNESS WHEREOF, Borrower has executed or caused to be duly executed this Agreement and has affixed or caused to be duly affixed hereto Borrower's seal, on this ____________ day of April 19 78

R. V. SEGARS COMPANY, INC.

~~President~~ (SEAL)

SEAL
Attest:

~~Vice-President~~

NOTE: Corporate applicants must execute Loan Agreement, in corporate name, by duly authorized officer, and seal must be affixed and duly attested; partnership applicants must execute in firm name, together with signature of a general partner.

PHYSICAL CROP DAMAGE REPORT

For Applicant's Use

Applicant's Name R.V. Segars Co.

Type of Crop	Cotton	Peanuts	Corn	Soybeans		
	Crop #1	Crop #2	Crop #3	Crop #4	Crop #5	Crop #6
Actual Acres Planted	552.9	197.5	600.7	593.8		
Recoveries Rec'd or Expected						

I certify that the above is true and correct to the best of my knowledge.

1-4-78
Date

Ray V. Segars
Applicant

Verification of Yield	Crop #1	Crop #2	Crop #3	Crop #4	Crop #5	Crop #6
Established Normal Yield	697	/	83	No Record		

The above represents the established normal yields as determined by the organization which I represent.

1-4-78
Date

ASCS
Name of Organization

Signature of Representative
CED Lee ASCS

Verification of Loss	Crop #1	Crop #2	Crop #3	Crop #4	Crop #5	Crop #6
Percentage of Loss	68 %	%	78 %	55 %	%	%

The above represents our opinion as to the percentage(s) of loss sustained.

1-4-78
Date

Clemson Extension
Name of Organization

Donald W. White
Signature of Representative

FOR SBA USE ONLY	Acres Planted x	Established Yield	Percent x of Loss x	District Price---	Reserves -	TOT
Crop #1 Cotton	552.9	697	68	.628	✓	$164,56
Crop #2 Corn	600.7	83	78	2.43	✓	94,501
Crop #3 Soybeans	593.8	19.6	55	5.74	✓	36,74
Crop #4						
Crop #5						
Crop #6						
TOTAL Eligible AMOUNT					✓	$295,813

1-10-78
Date

Moses Ashford
Loan Officer

[illegible]

PHYSICAL CROP DAMAGE REPORT

For Applicant's Use

Applicant's Name R. V. Segars Co.

Type of Crop	cotton	Peanuts	Corn	S. Beans		
	Crop #1	Crop #2	Crop #3	Crop #4	Crop #5	Crop #6
Actual Acres Planted	389.4	212.2	405.7	556.3		
Recoveries Rec'd or Expected						

I certify that the above is true and correct to the best of my knowledge.

1-5-78
Date

Applicant

Verification of Yield	Crop #1	Crop #2	Crop #3	Crop #4	Crop #5	Crop #6
Established Normal Yield	480	—	87	—		

The above represents the established normal yields as determined by the organization which I represent.

1-5-78
Date

Sumter A.S.C.S.
Name of Organization

Elizabeth N. Means (acting)
Signature of Representative

	Cotton	Peanut	Corn	Soybean		
Verification of Loss	Crop #1	Crop #2	Crop #3	Crop #4	Crop #5	Crop #6
Percentage of Loss	70 %	— %	80 %	60 %	%	%

The above represents our opinion as to the percentage(s) of loss sustained.

1.6.78
Date

Clemson Univ. Extension Service
Name of Organization

home
409.2352

William J. Parnell Co. Agt. [illegible]
Signature of Representative

FOR SBA USE ONLY	Acres Planted x	Established Yield	x Percent of Loss x	District Price	---Reserves	- TOT
Crop #1 Cotton	389.4	480	.70	.628	✓	$82,167
Crop #2 Corn	405.7	87	80	2.43	✓	68,615
Crop #3 Soybeans	556.3	20.5	60	5.74	✓	39,276
Crop #4						
Crop #5						
Crop #6						
TOTAL Eligible AMOUNT						$190,058

1-10-78
Date

Moses Ashford
Loan Officer

Total eligible amt. has been found

U.S. SMALL BUSINESS ADMINISTRATION

RECEIPT FOR AND CERTIFICATION OF USE OF PROCEEDS

SBA LOAN NUMBER (F) DL-B 948977 10 10 COLA

NAME R. V. SEGARS COMPANY, INC.

STREET ADDRESS RT. 1

CITY OSWEGO

STATE SOUTH CAROLINA

ZIP CODE 29121

For the purpose of inducing Small Business Administration, directly or through the ______________ ______________ participating lender, to disburse the above loan, or to guarantee its participating lender, to disburse the above loan, or to guarantee its percentage thereof, the undersigned borrower does hereby certify that the proceeds of this disbursement, on the account of this loan, will be used or has been used for the new crops as set forth below:

PURPOSE	Date and	APPROXIMATE AMOUNT (to be) used.
Rent.	March April	$40260
Chemicals	March-April.	115000
Fertilizer	Feb. March-April	76000
Labor	Jan-April	43373
Repairs	Jan-April	20200
Fuel	Jan-April	32530
Insurance	Jan-April	9485
Seed	March-April	37650
		374478

I (we) am aware that any person who knowingly makes a false statement or a misrepresentation by use of this certificate shall be subject to a fine of not more than $5,000 or to imprisonment for not more than two years or both, under provisions of the United States Criminal Code (15 USC 645 and 18 USC 1001) and that Public Law 92-385 provides that on all disaster loans made after August 16, 1972, anyone who wrongfully misapplies the proceeds of a disaster loan shall be civilly liable to the Administrator in an amount equal to one and one-half times the original principal amount of the loan.

I (we) realize that I (we) may be called upon to document my (our) use of the SBA disaster funds. Accordingly, I (we) will retain all documentary evidence (paid bills, cancelled checks and/or invoices) of my (our) expenditures for a period of not less than three years from the date of this certification, and will make them available to SBA promptly upon request.

The undersigned hereby acknowledges receipt on the date hereof of $______________ of the above loan. Further, the undersigned with the same knowledge certifies (1) that there has been no substantial adverse change in our financial condition, organization, operations, or fixed assets, since the application for this loan was filed and/or subsequent to the previous disbursement, and (2) that there are no liens or encumbrances against the real or personal property securing said loan except those referred to and disclosed in the application for this loan.

Corporate Seal

(Individual, General Partner, Trade Name, or Corp.)

BY President

TITLE 4-11-78

DATE SIGNED:

ATTEST (Title): Sec.

SBA Form 1161 (10-77) REF: SOP 50 30 1

GPO 922-171

U.S. SMALL BUSINESS ADMINISTRATION
2611 FOREST DRIVE
COLUMBIA, SOUTH CAROLINA 29204

11/30/76

Mr. Segars contacted this office this date requesting a deferment of 90 days. He has not harvested his soybeans and cotton as of this date but feels there will be no problem once the crops are harvested. Mr. McKenzie informed me that the loan would be just held in a delinquent stage until payment was received. Mr. Segars agreeded to this and said payment would be forwarded as soon as possible.

Miriam G. Brown
Disaster Loan Assistant

September 27, 1979

R. V. SEGARS COMPANY, INC.
Route 1
Oswego, South Carolina 29121

RE: SBA Loan No. (F) DL-B 948977 10 10-COLA

Dear Mr. Segars:

Your farm disaster loan referenced above is, as you know, seriously delinquent. Your first payment was due 12-1-78. The second payment is going to fall due 12-1-79, just a few weeks away.

We have tried to help you with your delinquent obligation, and have stayed in touch with you by letter, phone, and personal visit. We feel we have exhausted the remedies or alternatives available to us and cannot allow the delinquency to continue.

While completely sympathetic with the problems you are facing, we must protect the interests of the government in collecting monies due it.

This is to advise you that the delinquency must be completely cured within 3 weeks from the date of this letter, or we will be obliged to proceed with all available legal means.

We also want to know what your plans are for meeting your 12-1-79 payment in a prompt and timely fashion.

Sincerely,

R. E. Greenlee, Jr.
Disaster Branch Coordinator

U. S. SMALL BUSINESS ADMINISTRATION
STROM THURMOND FEDERAL BUILDING AND COURT HOUSE
1835 ASSEMBLY STREET
COLUMBIA, SOUTH CAROLINA 29201

Date: May 21, 1980

Reply to Attn of: Mike Harmon

Subject: R. V. Segars Co. Inc.

To: R. E. Greenlee, Jr.

Called Farmers Home to discuss Mr. Segars account. There has been a personnel change in the Lee County Office. Paul Booth who was in this office and is familiar with the Segar operation has been moved to another location. Bill Finley has taken Mr. Booth's place but is not at all familiar with the Segars.

I was able to talk to one of the ladies there by the name of Frances Kelly. Mrs. Kelly seems to know a good bit of information about the Segars. Mr. Segars has been approved for an operation loan for 1980 but funds will not be disbursed until he pays his 1979 operating loan in the amount of $480,000.00. This particular loan was due 12-31-79. This loan is tied into Segars Crops so Farmers Home Administration will be paid before anyone else. Mr. Segars reported to them the crops were behind schedule but things would be worked out shortly. Mr. Segars also has a $150,000.00 loan that is due but instruction were to work the operating loan first. Aside from this debt Farmers Home Administration made Mr. Segars A $2.1 Million Loan secured by Real Estate and equipment. This loan has been deferred for 2 years with the first payment due in 1981. As soon as Segars pays this 1979 operating loan he will be given a 1980 operating loan for approximately $480,000.00. Mrs. Kelly said she knew of no way Segars could pay any payments at this time. She also said they had no problem communicating with Segars.

Based on this information, I feel that if applying enough pressure to Mr. Segars does not produce his payment to S.B.A. then we should immediately put this loan into Liquidation. Please Advise

Mike Harmon MH
Disaster Loan Officer

12

MODIFICATION OR ADMINISTRATIVE ACTION
(For Inter-Office Use Only)

SECTION A - IDENTIFYING DATA - Prior to this Action

1. Name (incl. trade) and Address (incl. ZIP):
Borrower/Lessee R. V. Segars Co., Inc.
Route 1
Oswego, S.C. 29121

☐ Partic.
☐ SBC
☐ Lessor
(Name and Address): N/A

2. Loan Approval
Date 03-11-78
Gross $485,900.00
SBA Sh $485,900.00
SBA Part % 100.000

3. Type

	D	IP	G	X GP	L G
Bank Serviced					
SBA Serviced	X				

Date - XGP Purch. ______

4. Disbursement: (Gross)
Date - 1st ______
Last 04-11-78
Tot. Amt. 485,900.00
Fully Disbursed? Yes ☒ No ☐

5. Servicing Office No.: 0464
6. Classification: Current ☐ Delinq. ☒ Col. Pur. ☐ In. Liq. ☐ Chg. Off ☐
7. Delinquencies: No. Payments 1
Total Amt. $46,235.00
8. Loan Balance: $ 475,128.50 + Interest
9. Appraised: Date ______
By Whom: ______
10. Values ($000):
All Col. or Col. Pur. ______
Prior Liens ______
11. Maturity Date: 12-01-92

a. Loan/Case No.: 9 4 8 9 7 7 1 0 1 0
b. This Action No. 0 3
c. Report Date: 0 7 0 3 8 0

SECTION B - INSTRUCTIONS TO B&F - For this Action

REFERENCE ADD CHANGES ONLY
1. Charge Off Loan (Enter 416)
2. Reestablish Ch-Off Loan (Enter 410)
3. Terminate Gty. Loan (Enter F or V only)
Effect. Date Gty. Loan Term.
4. Approval Amount B&F use only (Trans CD)
Increase Gross by +
Incr. SBA Sh. by +
Reduce Gross by −
Red. SBA Sh. by −
Reinstate Gross
Reinstate SBA Sh.

REFERENCE FOC CHANGES ONLY
5. Redesignate Servicing Office
6. Revise Instal. Type (Enter F, P, or X)
Revise Instal. Freq. (Enter M, Q, S, A, or X)

B&F USE ONLY

J	F	M	A	M	J	J	A	S	O	N	D

Revise Instal. Amount
Revise Next Instal. Due Date 0 8 1 5 8 0
Revise Maturity Date
If above revised installment amt is temporary,
Future Instal. Amount
Future Instal. Due Date 1 2 0 1 8 0
Issue New Repay. cards to Bor. (Enter 00)
7. Transfer Loan to In-Liquid. (Enter 436)
Trans. Loan from In-Liq. to servicing (Enter 437)
Date Loan Trans. to or from Liquid.
8. Date Loan Trans. to In-Litigation
Enter Date Loan Removed From In-Lit.

Ref. 9-30 (Explain)
**Interest payment received
Principal only being deferred

Ref. 12	Date deferred to (123)	8-15-80	22-27
	Loan cured by deferment	02	28
	Number of months deferred	8	58-59
	Gross amount deferred	$46,235.00	60-69
	Total number of months to maturity-149		

SECTION C - JUSTIFICATION AND APPROVAL SIGNATURES - For this Action SOP 50-50-2 PARA. 82

Loan was approved on March 11, 1978 for (15) fifteen years maturity. Borrower experienced a great amount of expense with his irrigation system and applied for funding through Farmers Home Administration. He had not received all his money therefore he is unable to meet this payment now. He will be in a position to pay on 8-15-80. Borrower has requested a deferment to 8-15-80 by paying the accrued interest.

In view of the situation, L/O feels a deferment to 8-15-80 is in line and this action would not have any adverse affect on this agency.

do
I (~~do~~) (~~do not~~) Recommend:
Mike Harmon
Mike Harmon
Disaster Loan Officer

I (do) (~~do not~~) Approve:
R. E. Greenlee, Jr.
Disaster Branch Manager

TTHOMPSON:7-3-80

SBA FORM 327 SOP 20 21 (1-80) PREVIOUS EDITIONS OBSOLETE

October 31, 1980

R. V. Segars Company, Inc.
Route 1
Oswego, S. C. 29121

Re: Disaster Loan No. FLDB 948 977 10 10 COLA.

Dear Mr. Segars:

The R. H. Ritchey Accounting Firm of Alexandria, Virginia has furnished this office with copies of a Report of Audit performed at your place of business on July 15, 1980. The scope of this audit was to determine if any of the conditions of the basic authorization under which your 1977 disaster loan was granted had been violated.

The following significant violations were reported:

1. Financial Statements not submitted.
2. Delinquent payments.
3. Payments from another federal agency not reported.
4. Excess crop yield not reported.
5. Misuse of loan proceeds.

According to our records the violations have not been corrected. Please advise us at your earliest convenience how and when you will bring your loan into compliance with the original authorization.

It will be necessary for you to:

1. Submit financial statements on a timely basis.
2. Make future payments on a timely basis.
3. Make remittance to S.B.A. of $39,063.81 received from A.S.C.S. Failure to remit duplicate benefits may result in considering this loan in default. Please be in touch with this office if you are not able to pay within 03

30 days.

4. Likewise, under the terms of the authorization you were required to report if actual yields were greater than estimated yields. Since the overestimate of loss in yield resulted in a larger loan than you were entitled to, the overpayment, which amounted to $73,829.00, should be remitted to S.B.A. Notify this office if you are unable to make this payment within 30 days.

It was reported that you used part of the proceeds of your loan to purchase $55,117.00 in commodity futures. On April 11, 1978 you signed a certification stating that $374,498.00 would be used for working capital purposes. It would appear that a serious misuse of proceeds in violation of the Authorization occured. If this is the case, the funds so used must be returned immediately. Our legal department is reviewing your file for possible action.

Please do not hesitate to get in touch with this office if you have any questions or need further explanations.

Sincerely,

Robert E. Greenlee, Jr.
Disaster Branch Manager

REG/jj

October 31, 1980

Vern F. Amick
District Director

Audit Report No. 7(b) 80-04-64-253-COLA. on FLDB 948-977-10-10-COLA., between Small Business Administration and R. V. Segars Company, Inc.

Raymond F. Randolph
Assistant Inspector General for Audits
Office of Inspector General
Washington, D. C.

We acknowledge receipt of your memorandum and copies of the R. H. Ritchey Report of Findings for R. V. Segars Company, Inc.

We have been advised that the loan authorizations we used were worded in such a way as to be legally unenforceable because they require that S.B.A. only be advised of disaster payments from other agencies and only be advised when yields and income exceeded expectations. The authorization did not specifically require restitutional payments. We can only institute proceedings when some other element of fault or fraud is evident, in which case we will declare the loan in default and place it in liquidation and/or litigation. We will get in touch with the borrower to request that he make restitution to the S.B.A., but will not be able to force collection.

We do not feel that other violations cited such as financial record-keeping, failure to submit financial statements and false compensation agreements are serious enough to make an issue of at this time. These types of criticisms will be covered by loan officers while making routine field visits at a future date. Staffing limitations restrict this at the present time.

With regard to apparent use of proceed violations, we intend to require that funds used for purchase of commodity futures by borrower to be returned. If our counsel can prepare a sound legal action, and it becomes necessary to do so, it is our present plan to put the loan into liquidation add pursue legal means to recovery.

With regard to the requirement that flood insurance be obtained if the borrower's property is determined to be in flood hazard area, we have no knowledge that any of his property is so classified.

Vern F. Amick
District Director

JLJ;103180

[illegible] 8/24/81

Federal Emergency Management Agency
Washington, D.C. 20472

AUG 14 1981

Honorable Lowell P. Weicker, Jr.
Chairman
Select Committee on Small Business
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This is in response to your letter of July 21, 1981, to Louis O. Giuffrida, Director of the Federal Emergency Management Agency. In your letter, you requested our views on the circumstances under which the Government can institute proceedings to collect excess or duplicate disaster loan payments and whether the Small Business Administration (SBA) requires a delegation of authority from FEMA to recover payments for these loans. As General Counsel of FEMA, I am responding on Mr. Giuffrida's behalf.

In my view, the Federal Government, acting through its departments and agencies, has a clear legal right and an obligation to take action to collect any debt which is owed. I believe this authority and duty stems from the statutory responsibility of agencies to manage and administer Federal programs, whether or not that agency's specific legislative functions authorize either the recovery of funds expended by error, or otherwise provide for the collection of obligations and debts owed the Government. Several important Federal cases support this finding, including Mount Sinai Hospital of Greater Miami, Inc. v. Weinberger, 517 F.2d 329 (1975); U.S. v. Barlow, 132 U.S. 271 (1889); and Wilson Clinic & Hospital v. Blue Cross of South Carolina, 494 F.2d 50 (1974).

On this basis, I am of the opinion that the Federal agencies, including SBA, are authorized to pursue efforts to recover duplicative disaster loan payments for loans issued under their applicable statutory authorities. Additionally, I would point out that the Federal Claims Collection Act and the False Claims Act contain provisions by which SBA may initiate steps for the collection and recovery of excess or duplicative loan payments under its disaster loan programs.

As to the requirement for a delegation of authority from FEMA to SBA to collect for duplicative disaster loans, this issue was recently addressed in the Semi-Annual Report of the

Inspector General, SBA, covering the period October 1, 1980 to March 31, 1981. In this report, the Inspector General indicated that approximately $1 million in duplicate farm disaster loans issued under SBA's authorities would not be recoverable because FEMA had not issued a delegation of authority under Executive Order 12148 and the Disaster Relief Act of 1974 to SBA to seek collection from the loan recipients. Prior to receiving the Inspector General's final report, we were unaware of SBA's views on this issue and we have received no request for a delegation instrument to institute collection action.

Based on the legal analysis outlined above and on a review of the provisions of Executive Order 12148 and the Disaster Relief Act, I am of the view that SBA may take action to recover these loans without delegation of authority by this agency. The provisions of the Disaster Relief Act which were delegated to the Director, FEMA, by Executive Order 12148 and which address recovery of duplicate disaster benefits are contained in sections 315(a) and 315(c) of the Act. Those provisions, in my opinion, pertain to the authority of the Director, FEMA, to assure that there is no duplication of benefits under programs providing assistance under the circumstances of a "major disaster" declared by the President under the Disaster Relief Act and are not restrictive of any authorities of Federal agencies to seek recovery for duplicative or excessive payments for disaster losses authorized by other statutory authority. Additionally, I find several provisions in the Small Business Act - particularly at sections 636, 645 and 647 - as well as sections in SBA's regulations at 13 CFR 123, which address policies and procedures with respect to duplication of benefits for the disaster loans.

Consistent with the President's policies, the FEMA Director is now instituting new procedures to enhance our prevention of wasteful or fraudulent actions and to recover amounts owed the Government from past activities. While we do not now believe that a delegation from FEMA to SBA is required, we are most anxious to resolve this issue to assure that proper recovery actions can be taken by that agency. We have already held an initial meeting with officials from SBA to review their position and to explain our views and are scheduling additional meetings to resolve these questions. If it is finally determined that a delegation by FEMA to SBA is necessary for recovery action on these or other duplicative disaster loans outstanding, one will be immediately prepared for issuance by the FEMA Director.

I will keep you advised of our progress in resolving these issues.

Sincerely,

George Jett
General Counsel

SBC/SBA/Disaster [illegible]

July 21, 1981

General Louis O. Guiffrida
Director
Federal Emergency Management Agency
1725 I Street, N.W.
Washington, D.C. 20472

Dear General Guiffrida:

The Senate Small Business Committee is conducting a review of the Small Business Administration's (SBA) Disaster Loan Program and has scheduled hearings on this program for September 10th and 11th. As part of this review, the Committee is exploring the issue of collecting excess and duplicate loan payments.

One important area under review is SBA's authority to collect these loans. I would appreciate very much if you would provide to the Committee a written analysis and opinion as to the circumstances under which the government can institute proceedings to collect excess or duplicate loan payments and whether the SBA requires a delegation of authority from FEMA to collect these loans. If so, has the SBA ever requested such delegation of authority?

Thank you for your prompt attention to this matter. If there are questions, please contact the Committee's Chief Counsel, R. Michael Haynes, at 224-5175.

Sincerely,

LOWELL WEICKER, Jr.
Chairman

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

RECEIV
SBA
OFFICE OF REGIONAL COUNSEL
SEP 2 - 1980
AM 7,8,9,10,11,12,1,2,3,4,5,6 PM
A

Date: AUG 2[illegible] 1980

To: W. B. Grace, Assistant Regional Counsel
Atlanta Regional Office

From: GC:OL

Subject: Recovery of Farm Crop Disaster Loans Awarded in Apparent Violation of the Disaster Relief Act of 1974

This is in response to your subject memorandum dated August 8, 1980, concerning correspondence directed to your Atlanta, Birmingham, Charlotte, Columbia, and Jacksonville District Offices from the Inspector General.

② I have been advised by Julia Baysinger that FEMA has not, and will not, redelegate authority to SBA to accelerate indebtedness arising from SBA loans which duplicate benefits borrowers have received from the Farmers Home Administration. Since we cannot expect a redelegation under 42 U.S.C. 5155, the Agency does not have authority to call loans unless, as you have noted, a specified event of default in the loan documentation can be established.

Under the circumstances, I suggest that each of your District Counsels concerned with this matter review each file referred by the Inspector General for possible grounds for acceleration. As you know, there are covenants in disaster notes which would support calling any loan; (1) where the loan proceeds were not used for the purposes intended, or (2) where misrepresentations have been made in the application for the loan. For an example of the latter see the fourth paragraph, SBA Form 403, which provides for acceleration as follows:

> "(3) Payee's discovery of the Undersigned's failure in any application of Undersigned to Payee to disclose any fact deemed by Payee to be material or of the making therein or any other documents submitted in connection with said application submitted in connection with said application or said indebtedness, of any misrepresentation by, on behalf of, or for the benefit of the undersigned."

The foregoing provision also appears in SBA 1030B. Also, SBA Form 1030(a)--Total Cancellation-- may establish grounds for acceleration in cases where there has been a wrongful misapplication of loan proceeds.

After counsel has reviewed his or her files, a report on the activity of the office with respect to each case should be made to the Inspector General. Erin McDonnell has been involved in this problem and will also advise the Inspector General's staff that repayment on some cases cannot be legally supported.

Thank you for bringing this matter to our attention.

Robert B. Webber
Associate General Counsel

CC [illegible]

1375 xxxx

May 31, 1978

Merritt Scoggins
Assistant Regional Director for F & I

AGRICULTURAL DISASTER SERVICING POLICY

Thru: Wiley S. Messick
XX Regional Director

To: Associate Administrator for Operations
SBA - Washington
Attention: B. Kulik

May I direct your attention to Bulletin 13, SOP 50-30-1 and specifically Part I V Loan Authorization. The requirement in (A) states, "Borrower agrees to notify SBA if the actual yields on the damaged crops exceed the following estimated yields". (You are aware that the great majority of our applicants filed on the basis of estimated yields.)

Also, the requirement in (B), "that the applicant will notify SBA of any funds received from any source whatever, which could be considered as reimbursement for losses suffered, is needed so that the amount of eligibility can be adjusted (i.e. ASCS grant programs)." And, further that the paragraph in the authorization is to read, "Borrower agrees to notify SBA of any funds received from any source .....". Regional Counsel Coker advises that this language requests only that the borrower notify us of such payments, not specifying that refunds are to be made. I am informed we have already had instances where borrowers have simply notified us of the ASCS payments and made no indication that a refund will be offered.

The District Directors involved in the farm disaster loans have been discussing these points with me. During the GAO reviews of our Districts and our farm disaster lending policies, they (GAO) raised the question as to our plans in following up on these matters with the borrowers. I am enclosing for reference a recent memo from Vern Amick which covers these same matters.

The point of all this is to bring these problems to your attention. We need some guidance as to how we as an agency intend to enforce these requirements. What will be our policy; should we,

1. Rely solely on the borrowers honesty to bring these matters to our attention for adjustment, or

2. Aggressively follow up with the borrowers and all information sources with respect to actual harvested yields, and ASCS payments, etc?

If we choose to be aggressive with follow up, our personnel requirements are going to be demanding and the question arises what our practical recourse may be if we discover borrowers have actual yields that exceeded estimates; or received ASCS payments, etc. Do we go ahead and make demand and call these loans,foreclosing for whatever equity is available? We must remember we did not take specific liens, but simply recorded for whatever was available and we basically are dealing with paper equities.

Your advice and guidance will be appreciated as to the future policy in regard to these matters.

Merritt Scoggins
Assistant Regional Director
for Finance and Investment

cc: Reading File - RD

MEScoggins:amp:ARDFI:5/31/78

August 28, 1978

Merritt E. Scoggins
ARD/FI - Atlanta R/O

AGRICULTURAL DISASTER SERVICING POLICY

Associate Administrator for Operations
SBA - Washington
Attention: B. Kulik

Please refer to our memorandum request, above subject, under date of May 31, 1978 (copy enclosed).

We have not yet received your policy response to the questions that were raised. Some of our District Directors are extremely concerned about our approach to the matters in question. This is due to the interest GAO Reviewers indicated while conducting their inquiries into the administration of the Farm Disaster Program.

We continue to feel that the Districts need written advice and guidance as to the agency policy as regards to these important matters.

Wiley S. Messick
Regional Director

Enclosure

MEScoggins:ARD/FI:sr:08/28/78

U. S. SMALL BUSINESS ADMINISTRATION
REGION IV
1375 PEACHTREE ST., N.E., 5th FLOOR
ATLANTA, GEORGIA 30309

Date: November 30, 1978

Reply to Attn of: Regional Director

File

Subject: Duplication of Disaster Benefits

To: Harold A. Theiste
Acting Associate Administrator
for Operations
SBA - Washington, D.C.

Our regional and district management staff continue to be concerned about the subject. Inquiries earlier this year by the GAO task force interested in the administration of these farm disasters indicated a further follow-up. Regional Counsel has made a recent study into this problem. Attached is an opinion and recommended approach which we hope you will have promptly reviewed at the Central Office level. We propose to follow-up on this matter within 15 days unless you object. Our districts will be instructed to mail the proposed letter to the farm disaster loan recipients. Any funds recovered will be applied IOM (Inverse Order of Maturity) to the outstanding principal balance of the loan.

③ Also, you will find attached copies of our previous memorandums concerning this subject. We have never received instructions from Central Office regarding this problem.

Wiley S. Messick
Regional Director

Attachments (3)

DISTRIBUTION:
RD
RC
D. WHITLEY
C. KELLEY
F. FLEISCHMAN

"THE FEDERAL GOVERNMENT IS AN EQUAL OPPORTUNITY EMPLOYER"

WASHINGTON, D.C. 20416

RECEIVED
DEC 1 - 1978
SBA

Date: DEC 8 1978
Reply to attn of: Office of Portfolio Management

Subject: Duplication of Disaster Benefits

To: Wiley S. Messick, Regional Director
Region IV

This is in response to your memorandum of November 30, 1978, and in confirmation of a conversation between Messrs. Scoggins and Kelly and Office of Portfolio Management staff.

This office shares your concern to assure that Agency lending conforms with the law as regards interagency duplications of benefits. We are aware that potential duplications exist between SBA, FHA and ASCS programs, and it is our desire to establish worthwhile procedures to identify and resolve any such situations and are having continuing discussions with our Inspector General and staff in this regard.

Efforts have been underway for some time to effect a computer match of SBA loan recipients with disaster benefit recipients of FHA and ASCS. We anticipate that lists of potential recipients of duplicate benefits will be available shortly. It is our intent to use this interagency information as the basis for the resolution of this issue. In this regard, we intend to publish guidelines for followup so that all offices will approach the problem in a uniform and reasonable manner.

④ Please be assured that the issue is being dealt with and that no independent action is necessary by your staff. In the interim, we will keep you fully informed and request your advice of any significant developments which come to your attention. Of course, any suggestions you may have will be welcomed.

Edwin T. Holloway

Edwin T. Holloway
Director
Office of Portfolio Management

SBA - REGION IV
AED
FINANCE & INVEST

Senator **Weicker**. Senator Rudman?

Senator **Rudman**. Thank you, Mr. Chairman.

I have no statement at this time.

Senator **Weicker**. The committee will then call its first witness, the Inspector General, Paul Boucher.

Mr. Boucher, if you will come and be sworn.

Do you swear to tell the truth, the whole truth, and nothing but the truth, so help you God?

Mr. **Boucher**. I do.

Senator **Weicker**. I want to say at the outset that I have enormous respect for the Inspector General. Indeed, I was more than a little upset when all Inspectors General were terminated, or whatever expression was used, and we lost the services of Mr. Boucher. Then I give credit to the administration for putting him back on board. I think you are a great credit to Government.

Believe me, it was not that you did not warn people as to what was going on in this as in so many other situations that we have had during the course of this general oversight of the Small Business Administration.

I am delighted that you are back on board as the Inspector General of the agency.

TESTIMONY OF PAUL BOUCHER, INSPECTOR GENERAL, SMALL BUSINESS ADMINISTRATION

Mr. **Boucher**. Thank you, Mr. Chairman. I am pleased to be back, too.

Mr. Chairman and members of the committee, as you know, I last testified before this committee on the subject of the Small Business Administration's disaster program on May 15, 1981. At that time, I described the past activity of the Office of Inspector General as it relates to that program and outlined some of the management and administrative problems associated with the program. I also indicated evidence of abuses and possibly criminal activity developed by our very limited audit and investigative activities.

Seventy percent of all loans made by the SBA are disaster loans. SBA now has more than $6.3 billion in disaster loans outstanding. This amount represents 38 percent of all loan dollars outstanding in SBA's portfolio.

Inadequate staffing in the program, the only SBA program which relies almost exclusively on temporary employees, in my opinion underlies many of the serious problems we found. Not the least of these problems is the fact that SBA cannot service its loans nor vigorously collect its past due debts.

As a result, $1.2 billion in disaster loans alone is either past due, delinquent, deferred, or in liquidation. That amount represents about 20 percent of all disaster loans. In the New York region alone, approximately 32,000 disaster loans valued at nearly $122 million are in not current status.

The initial Office of Inspector General effort directed toward the disaster program was investigative in nature. It began in 1979 when the SBA and the U.S. Department of Agriculture Offices of Inspector General matched computer lists to determine the extent to which farmers might be receiving duplicate loans for the same disaster loss from both SBA and the USDA's Farmers Home Administration, also known as FmHA.

Subsequent review of some 1,300 loan files disclosed that approximately 119 recipients had apparently received duplicate loans amounting to over $2 million. As important as the amount of money involved, was our discovery that in some locales SBA and FMHA failed entirely to coordinate their activities, thereby opening the door to fraud and error.

This computer match and investigation resulted in the referral of 10 cases to the Department of Justice for possible criminal prosecution. Followup action on all these cases has resulted in recoveries of $1.5 million to date in Mississippi, Georgia, Texas, Alabama, New Mexico, Kansas, Iowa, and South Carolina, with further recoveries expected.

In July 1980, we recommended a system of cross-agency checks to preclude future large-scale instances of duplicate loans. Our recommendations were adopted and implemented by SBA.

During 1979, the SBA Office of Inspector General hired a small CPA firm to make limited-scope audits of selected disaster loans throughout the United States. The primary purpose of these audits was to determine whether the borrower complied with program loan laws and regulations and with terms and conditions of the contract. The audits also included a limited-scope review of loan servicing practices by SBA.

These audits were made in 24 SBA district offices in 9 of the 10 SBA regions and primarily covered agricultural disaster loans made from January 1, 1976 through June 30, 1979. A total of 438 loans was subjected to review. Even with this relatively small sampling of loans, the auditors found in many of these cases that borrowers had not reported crop yields in excess of the estimated loss upon which the SBA loan amount was based, or had misused the loan proceeds, or had not reported payments from other Federal agencies. Some borrowers engaged in all three practices.

Having said this, Mr. Chairman, let me cover briefly what each of these categories of audit findings means. The most significant finding deals with "excess crop yields." During the period covered by this audit, SBA routinely predicted the eventual loss in crop yields caused by the disaster and used this estimate to compute the amount of disaster loan entitlement. The data used for developing the estimates were usually provided to SBA by agencies of the USDA.

At harvest, if actual crop yields exceeded expectations, or, put another way, the crop loss was not as great as originally predicted, SBA procedures required the farmer to report the actual crop yield to SBA so that the loan balance could be reduced by an amount equal to the value of the excess yield.

By way of illustration, some Georgia farmers were granted loans during August and September 1977 for estimated crop losses on soybeans and pecans. During October and November, and prior to harvest, considerable rainfall resulted in yields far in excess of original predictions. In effect, these farmers suffered little, if any, losses on their crops. Relatively few farmers reported these windfalls to SBA. For its part, SBA made no effort to verify ultimate crop yields.

In Texas, the drought caused acres of grazing lands to dry up. SBA made substantial loans to affected farmers for the purpose of reseeding the pastures. Soon after the loans were made, it rained and the grazing lands recovered. In both these examples, and others, farmers obtained the use of large sums of U.S. taxpayers' money in loans at interest rates of from 3 to 6 percent for as long as 15 years when they did not actually need the loans in the amount disbursed, or did not need them at all.

Estimating crop losses in the midst of a disaster, is at best unscientific. Furthermore, compensating for predicted losses is in itself a debatable practice. After gaining some experience in what was a new area of disaster lending, SBA recognized these and other problems and changed its policy in 1978. SBA will now approve no loan until after harvest. This change should largely preclude the problem of "excess crop yields." Our audits disclosed approximately $6.7 million in the category of "excess crop yields."

The next significant audit finding was the possible misuse of loan proceeds. At the time the loans in question were made, SBA regulations specified that no more than 50 percent of the loan proceeds could be used to satisfy preexisting debts. The remainder of the proceeds was to be used for planting of next year's crops.

While it is often quite difficult to conclude firmly that a borrower has misused loan proceeds, in many cases the misuse is egregious and blatant. For example, some farmers used the entire loan proceeds to discharge high-interest debts or develop real estate. Other farmers purchased capital equipment to replace similar equipment which was in no way affected by the disaster. Proceeds believed to have been misused were estimated by the auditors at approximately $6.4 million.

The fact that farmers were frequently given unneeded funds which they put in interest-earning instruments for as long as a year was noticed by SBA in 1977. In October of that year, loan procedures were changed to require a showing of immediate need before loan funds were disbursed.

The third audit finding identified the receipt of duplicate benefits from SBA and the Agricultural Stabilization and Conservation Service [ASCS]. In brief, ASCS is authorized to make soil conservation grants to farmers who have suffered crop losses. To the extent that these grants duplicate loans made by SBA for the same crop loss, they were to be reported by the borrower to SBA so that steps could be taken to adjust and reduce the SBA loan balance. In some cases, farmers received grants prior to their application for an SBA loan and either falsified their loan application by not reporting such grants, or were not asked by SBA about the grants at the time of application. Audit findings identified duplicate benefits amounting to approximately $2.3 million.

The dollar amounts attributable to these audit findings is significant. As I indicated earlier, a total of 438 loans was reviewed by the auditors. These were randomly selected from a universe of about 5,600 disaster loans in amounts of $100,000 or more made by 24 SBA district offices. These 5,600 loans totaled $1.2 billion.

As a result of this process, approximately $169 million in loans was audited. Of that amount, more than $16 million has been implicated within the three categories of excess crop yields, misused proceeds, and duplicate payments discussed above.

Analysis of the audit findings as a whole discloses a distinct geographic pattern. Approximately 195 loans, or 45 percent of the total, were made in offices within the jurisdiction of SBA's region IV, headquartered in Atlanta, Ga. That region's portion of the loans, however, represented nearly $11 million, or 70 percent of the total amount questioned by the auditors. That amount represents $5.5 million in excess crop yields, $3.8 million in possible misuse of proceeds, and $1.7 million in duplicate benefits. At this point, I should note that portions of the Southeastern United States which is serviced by region IV, were particularly severely hurt by droughts in 1977 and 1978.

The severe impact of these droughts on the operations of many farmers in the Southeast resulted in a great deal of pressure on SBA officials to quickly make loans. What resulted was a process that I have observed in every SBA program about which I, and the Comptroller General in other areas, have testified repeatedly. Too much emphasis was placed on delivery of assistance and too little on internal controls and sound management.

As a result, a situation developed in which loans were approved and processed in August 1977 before the first written guidelines could be prepared and sent to the field. In December 1977, the Regional Administrator noted the emergency situation and the need for getting the approved loans disbursed as quickly as possible. In an effort to expedite the process and due to shortages in his legal staff, he authorized loan officers to disburse the loans without prior review by SBA attorneys. He even suggested that the staff work on Saturdays, if necessary, to get the loans disbursed to the applicants.

The pressure felt by SBA at all levels had its desired effect. During 1977-78, thousands of agricultural disaster loans were made by 14 SBA disaster offices staffed by a total of 260 temporary disaster employees. At the present time, the Atlanta region alone has 47,705 disaster loans valued at $1.5 billion in its servicing portfolio. Of this, 23,875 are farm loans valued at nearly $1 billion.

I believe that this number is quite significant in terms of any efforts which may be undertaken to recover loan proceeds. For example, our audit disclosed that there are 2,640 loans in region IV which were made for amounts of $100,000 or more. Their total value was $502 million. We selected only 195 of these loans, or 7.4 percent, for audit, and linked over $11 million with the audit findings for these relatively few loans.

Any effort to review the remaining 2,445 loans, particularly if the review could target those loans made to farmers whom we know had excess crop yields—for example, in connection with soybean or pecan harvests—would suggest the possibility of perhaps as much as $100 million or more in potentially recoverable loan proceeds. This does not take into account the additional thousands of loans made to farmers for amounts of less than $100,000, many of whom may well have similarly higher crop yields, received duplicate benefits, or misused loan proceeds.

The Office of Inspector General informed the regions covered by this audit activity of its preliminary audit findings. We asked that they initiate appropriate action to recover loan proceeds relating to our audit findings. To date, in region IV alone, SBA has either recovered or received agreements to pay back funds from borrowers which total $1.5 million; an additional $1.4 million has been demanded from borrowers by the SBA. I think it is significant to note that the audit activity which triggered these and future collection efforts cost the SBA Office of Inspector General approximately $245,000. I believe that is an excellent return on the use of contract funds.

At the same time that some recoveries were made, some regional and district officials inquired as to the legal grounds for recovery of funds associated with the audit findings.

The Office of Inspector General requested that program officials work with district and regional SBA attorneys to discuss any legal issues and devise feasible collection methods. Concurrently, this committee began to express an interest in SBA's disaster operations, including the issue of legal remedies. On July 30, 1981, I requested that the General Counsel's Office review the issues involved in our audit findings and identify practicable and effective legal remedies to guide the Agency's collection efforts.

Since that request, Mr. Chairman, we have engaged in discussions with representatives of the Office of General Counsel on a number of issues related to SBA's ability to collect excess crop yield funds, duplicate benefits, and misused proceeds. It is my understanding that the General Counsel is developing a plan of action for institution of collection procedures against borrowers to recover amounts associated with these findings. These actions will follow a review of the audited loan files and the development of additional information on the thousands of other borrowers who received SBA assistance. Actions which are expected to result include negotiation of voluntary agreements by borrowers to repay overpaid or misused funds, acceleration of entire amounts of indebtedness, and coordination with the Department of Justice for the purpose of initiating actions to impose civil penalties for misuse of loan proceeds. My office will be following up in the coming weeks and months to evalute SBA's progress in these recovery efforts.

Based on the results of our limited audit activity, Mr. Chairman, I believe that the findings of noncompliance can be attributed to the activities of both SBA and those farmers who received SBA assistance. The disaster loan program relies heavily on voluntary compliance with the terms of the loan agreement and authorization by farmers and other borrowers. Again, in my opinion, this is partly the result of a history of inadequate staffing to properly service a loan portfolio in a program which places greatest emphasis on the rapid delivery of assistance to a large number of borrowers in times of crisis or tragedy.

I think that one example of the type of difficulty facing SBA managers can be illustrated by a letter recently received by the Office of Inspector General from the SBA District Director in Columbia, S.C. In responding to our requests that action be taken on our audit findings, he wrote in part:

> Presently we have four loan officers to serve approximately 3,000 business disaster loans and with the proposed cutback by the end of September, we will have only

two. We need a minimum of 10 to adequately service these loans. To follow up on actual or potential violations would require an even larger staff.

I hasten to add, however, that despite the lack of personnel resources, this District Director has still attempted to mount an aggressive effort to correct deficiencies, has made demand for repayment from SBA borrowers and, in fact, has already recovered more than $580,000.

At the time that our audit and investigative activities were being carried out, the Inspector General's Advisory Council was preparing its first report. That report, which covered all aspects of SBA's disaster program, was released in May of 1981. Copies have been furnished to this committee. It detailed a variety of problems and recommended solutions based on the viewpoints and experience of the professional SBA employees who served on the Council. The views in the report are those of SBA employees who have been making a sincere effort to make disaster operations work. Their criticisms reflect the frustrations encountered in years of making that effort. The report offers another perspective of the problems in disaster lending operations that our audits and investigations have brought to the fore.

The Council made several major recommendations for improvements including: upgrading the Office of Disaster Operations to a major SBA division headed by an Associate Administrator; hiring five area managers to direct an expanded 500-person permanent disaster cadre; revamping disaster declaration criteria to make sure that disaster assistance goes only to the truly needy and does not merely compensate for insurable or predictable business risks; strengthening collection procedures to reduce the nearly $1.2 billion in disaster loans which are past due, delinquent, or in liquidation; improving guidelines for surveys, loss verification, and loan processing to reduce fraud and error; simplifying the loan forms and making other improvements to resolve the vulnerability of disaster victims to con artists; and beginning systematic contingency planning to prepare for disasters instead of merely reacting to them.

Administrator Cardenas has personally reviewed the Advisory Council report. I believe he is prepared to adopt a number of the recommendations contained therein.

Mr. Chairman, I believe that the Advisory Council concept has proven itself to be an effective means for giving concerned SBA employees a place to make frank criticism of stated agency policy and practice without fear of reprisal.

I fully expect to have a second Council formed early in the new fiscal year. This Council will study SBA's loan-making, loan-servicing, and loan-liquidation practices. It will study, criticize where necessary, and make recommendations designed to improve SBA's debt-collection activities. I would note that the response of SBA employees to our call for volunteers has already resulted in more than double the number of volunteers for the first Council.

Based on our limited audit activity, and in an effort to supplement those of the Advisory Council, I would offer, Mr. Chairman, the following interim recommendations for consideration by SBA officials responsible for its disaster lending programs and, where appropriate, by Congress.

Initially, under no circumstances should the SBA disburse the proceeds of any loan absent a review of the legal sufficiency of the entire loan package by an SBA attorney.

Additionally, consideration should be given to inclusion of a provision in all disaster loan agreements which would permit SBA to adjust the interest rate on the loan upon its determination that certain conditions have occurred; for example, misuse of loan proceeds or failure to apply excess loan amounts to reduce the outstanding loan balance.

In effect, I am suggesting that to the extent that a borrower has not complied with certain terms of the loan agreement, the borrower should not be allowed to continue to use the very same favorable interest rates as those who have abided by their agreements.

For example, consistent with practices which apply in the private sector, SBA could have the authority to call a note for the purpose of renegotiating the interest rate to one more closely approximating, at a minimum, the cost of money to the Government. Particularly in cases where misused or excess amounts could not be immediately recovered by the Government without the relatively more drastic consequence of a foreclosure, this provision could be considered as an interim measure which would reduce or eliminate the amount of the interest subsidy being paid by the Government.

Those who might consider this proposal to be unduly harsh should bear in mind that the borrower would continue to have the use of funds at favorable rates over those of the commercial market and still avoid the immediate and drastic results of a Government foreclosure action.

In the same vein, a recurring issue raised by members of the Inspector General's Advisory Council, as well as others experienced in loan servicing, relates to the very liberal deferment practices which have been followed by SBA. I would suggest that our deferment policies be reviewed. In an effort to discourage requests for unnecessary deferments and to remove from SBA some of the burden of making a judgment on the merit of the deferment, SBA might consider adopting measures which would permit it to incrementally raise interest rates on amounts carried in a deferred status. This proposal, I believe, would require amendment of the Small Business Act provision dealing with such deferments.

If this is not feasible, at a minimum SBA should develop guidelines which would require clear and convincing evidence that a deferment is clearly warranted.

Mr. Chairman, I referred at the outset of my testimony to the New York disaster loan situation. The handling of the problem in New York City alone has resulted in some rather innovative and successful action by the District Director and his staff. In effect, he has begun a well-publicized crackdown on individuals who are delinquent on home disaster loan payments. Through close coordination with the U.S. attorneys' offices in the eastern and southern districts of New York, and person-to-person visits with borrowers, nearly $1.3 million has been collected from previously delinquent borrowers over a 6-month period of time. The District Director predicts that these collection figures can be doubled in the next 6 months. While not in any way related to agricultural disaster loans, I believe that the New York experience demonstrates what can be done, even with limited resources, when there is effective interagency coordination and a commitment to a vigorous program of debt collection.

On the general subject of debt collection, I would like to offer my general comments about the Government's practices in general in this area.

Mr. Chairman, an individual's good credit rating is generally a most valued possession. In the past, Government agencies have been unable to take part in a process widely used and heavily relied upon in the private sector. I refer to the practice of reporting to credit agencies those individuals or firms which have not lived up to their financial obligations. Just the threat of a report is often enough to encourage efforts by debtors to settle accounts with creditors. I generally support legislative initiatives reflected in several recent bills, particularly S. 1249, presently pending in the Senate, which would permit Federal agencies to provide reports on its debtors to credit reporting agencies.

Additionally, I would note that in April of 1981, the Department of Justice published a final rule in the Federal Register which would permit Federal departments and agencies to make use of private agencies to collect on overdue and delinquent debts. While the Small Business Act now precludes SBA's taking advantage of this alternative to the use of Government employees in these activities, I would support efforts to amend the act to allow SBA to utilize the services of these private agencies. Such authority would be one way of responding to the need to mount an aggressive debt collection effort while at the same time facing up to realities of efforts to reduce Federal employment ceilings.

In discussions with the committee staff prior to this hearing, I was asked to make any suggestions or recommendations which I believe might address some of the problems discussed here. I would offer the following for the committee's consideration.

In looking at Government-sponsored programs, Mr. Chairman, we often view them as services provided by a number of unrelated organizations with little, if any, demonstrable connection with one another. This perception is only underscored when we discover duplicate and overlapping programs within the executive branch. Improved interagency coordination is essential if we are to identify areas of exploitable weakness and consolidate our efforts. In this respect, I believe the Government ought to consider the feasibility of establishing a system which would allow the various departments and agencies to deny or adjust succeeding requests for financial assistance to an applicant who has not had a satisfactory record with another Federal agency or agencies.

For example, in the case of farm disaster loans, the SBA should use all currently available resources to collect misused, excess, or duplicate funds in the hands of borrowers. To the extent that we are able to demonstrate the existence of these windfalls but are not able to recover them, some consideration should be given to development—either by statute or regulation, if possible—of uniform interagency setoff procedures. Applied to the current situation, a farmer applying for disaster assistance from FmHA in the future might have his or her entitlement amount adjusted on the basis that assistance had been received from another agency—in this case, SBA—which proved to be in excess of the loss suffered.

As I noted, this would require effective coordination among all Government agencies involved in granting financial assistance. Precedent for this may be found in the processes which now exist with respect to debarred and suspended contractors. This system is now in the process of being improved and augmented so that it can be used more effectively to protect Government agencies from inadvertently contracting with an entity which has been debarred or suspended by another Federal agency.

The effect of any such system is the recognition that individuals dealing with the Government deal with a cohesive entity, and not a group of unrelated agencies with little, if any, relationship to one another.

Mr. Chairman, while some of these practices would be new to the Government, especially those dealing with debt collection and credit reporting practices, their adoption would do nothing more than place the Government on a similar footing with the private sector whose commercial lending practices and debt collection measures are well known to all individuals. Failure to pay on just debts yields a certain result in the private sector. That result should be no less certain when the Government is the creditor. The mere knowledge that the Government will take action will often provide sufficient incentive to most individuals to make required payments.

Adoption of such measures as these would, I hope, restructure a system which in effect has penalized the vast majority of Americans who are conscientious about fulfilling their obligations and responsibilities after the Government has used the taxpayers' money to provide assistance to them.

Mr. Chairman, that concludes my prepared statement. I would be pleased to answer any questions you may have.

Senator WEICKER. Thank you very much, Mr. Boucher.

We have been joined by Senator Dixon, Senator Nickles, and Senator Gorton. We will try to follow the 5- or 6-minute rule here so that everybody can get their questions in.

Let me say two things at the outset. I am not so sure that I would want to turn over this matter of credit reporting to the credit reporting agencies until such time as they clean up their act. As you know, we have had hearings before this committee on credit reporting. I am not at all satisfied with some of their particular practices.

However, the question I do want to ask at the outset relates to your comment on coordination between Federal agencies. Due to the change in the law and due to language placed into the law during the reconciliation process, I think the Small Business Administration is pretty much getting out of the disaster loan lending area as far as farmers are concerned.

Then my question has to be: Has the floating crap game closed up on one street and moved to another? In other words, the very weaknesses that you have correctly identified as applying to the process when it was under the aegis of the Small Business Administration, have you compared notes with the Inspector General and counsel over at the Farmers Home Administration to see that these same things do not take place?

Mr. BOUCHER. We have not yet compared notes, Mr. Chairman, but I am in touch on a weekly basis with my counterpart at the Department of Agriculture. I plan to discuss all these things with him.

Senator WEICKER. That is something we can coordinate as a matter of practice without having to change the law. Since now the bulk of this type of lending is going to come under FmHA, I suggest that that should be done immediately so as to preclude any reoccurence of the types of cases we are going to be discussing this morning.

In your testimony, you projected a rough estimate that $100 million in excess and duplicate loan payments might be identified if the entire universe of your audit was reviewed. You testified that this $100 million estimate is only for a universe of loans amounting to $100,000 or more. Is that correct?

Mr. BOUCHER. That is correct.

Senator WEICKER. There are more than 74,000 loans in SBA's disaster loan portfolio. The universe you examined consisted of only 5,600 loans. If you estimate that $100 million in excess and duplicate loans can be identified for only 5,600 loans, then what would your projection be for a loan portfolio of 74,000 loans?

Mr. BOUCHER. It would be some figure higher than that, Mr. Chairman. It would probably be several hundreds of millions. I have no way of knowing that. However, if the findings which we noted in our audits carry through to other areas, and I would have no reason to believe that they would not in many circumstances, I think we are talking hundreds of millions.

Senator WEICKER. Do you have any reason to believe that the conditions you found in your limited audit would not be found across the country?

Mr. BOUCHER. In varying degrees, certainly these conditions would probably be found across the country, Mr. Chairman.

Senator WEICKER. You stated that SBA was prepared to work with the Department of Justice in taking action to penalize farmers who misused loan proceeds. Could you elaborate on that statement?

Mr. BOUCHER. Mr. Chairman, a provision of law, 15 U.S.C. 636(b), states that the SBA, when it has evidence that loan proceeds have been misused, may bring a civil action through the Department of Justice to recover 1½ times the amount of the loan. That is the provision that I mentioned in my testimony with which we would be approaching the Department of Justice in a number of selected cases to explore the possibility of instituting civil action, particularly in the most egregious and blatant cases of misuse of proceeds. I think the congressional intent there was clearly to put a stop to the misuse of loan proceeds and that we ought to try that avenue.

Senator WEICKER. What is the total amount of recovery so far of excess and duplicate disaster payments resulting from your audits and investigations?

Mr. BOUCHER. I would like to break this down, Mr. Chairman, if I could, because there are three categories. In actual cash recoveries, there are approximately $2.35 million. We have received promises to pay, an acknowledgement that they owe, in the amount of $697,000. We have furthermore demanded $1.4 million. We therefore have promises to pay, or demanded $4.45 million. The bulk of that is in region IV.

Senator WEICKER. You testified that you referred 10 investigative cases to the Department of Justice. What became of those cases?

Mr. BOUCHER. Those 10 cases that we referred to the Department of Justice have had no prosecutions.

Senator WEICKER. I will get into the specific cases, Mr. Boucher, after having given my colleagues a chance to go ahead and ask any questions they may have.

Senator Dixon.

Senator DIXON. I have no questions, Mr. Chairman.

Senator WEICKER. Senator Rudman?

Senator RUDMAN. I just have two questions for Mr. Boucher. First, those cases that were referred to the Justice Department—I assume those are the cases that were absolute fraud under the United States Code in terms of duplicate loans for the same purposes?

Mr. BOUCHER. These were all cases where somebody received a loan from SBA and a loan from FmHA for the identical disaster. We took the approach that the second loan was the violative loan because you had to disclose the first loan in your application. These were all duplicate loans, Senator Rudman.

Senator RUDMAN. They all fell under that category?

Mr. BOUCHER. That is right.

Senator RUDMAN. How long ago were those referred to the Department of Justice?

Mr. BOUCHER. They have been referred over a period of time from 1978, 1979, and 1980.

Senator RUDMAN. Do you happen to know if any of them have been referred to the respective U.S. attorneys for those jurisdictions in which the alleged crime was committed?

Mr. BOUCHER. Let me clarify what I said. I included U.S. attorneys within the umbrella of the Department of Justice. A number of these cases went to U.S. attorneys' offices. A smaller number went to the Department of Justice here in Washington, D.C.

Senator RUDMAN. To your knowledge, have there been any indictments under these 10?

Mr. BOUCHER. To my knowledge, there have been none.

Senator RUDMAN. Some of them are how old?

Mr. BOUCHER. Two or three years.

Senator RUDMAN. Does this committee have a list of those 10 cases and to which U.S. attorney or to which responsible official in the Justice Department they were referred?

Mr. BOUCHER. I believe the committee does, Senator Rudman.

Senator RUDMAN. I intend to look into that.

Senator WEICKER. Thank you, Senator.

Senator Gorton.

Senator GORTON. Mr. Boucher, is there any policy or philosophical justification for having more than one agency of the Federal Government appropriating money for and eligible to make loans for disaster purposes on farms? Should not all of this authority be concentrated into a single agency? If it were, would not at least a significant number of the defects and deficiencies to which you have testified be cured automatically by doing so?

Mr. BOUCHER. I think automatically would be much too positive a term at this point based on what I have seen. We go back to the basic question. I was not here when SBA got into farm disaster lending. They are now, for all practical purposes, out of farm disaster lending.

I would have to agree that, rather than place another agency into the same lending arena, if there are shortages of personnel in the agency primarily responsible or whatever the case might be, build up that agency. Do not split the responsibilities between two or three different agencies. I agree that consolidation would probably eliminate a lot of the problems because you would have one system and one method for delivering services to people.

Senator GORTON. Would you recommend for the future what has actually happened during the course of reconciliation, that SBA get out of this business?

Mr. BOUCHER. Based on my experiences, yes, sir.

Senator GORTON. That still leaves two separate agencies, FmHA and ASCS, which are in the business, does it not?

Mr. BOUCHER. Those are two subagencies of the Department of Agriculture, I believe. One makes loans and the other provides agricultural grants.

Senator GORTON. They do not duplicate one another's function?

Mr. BOUCHER. I do not believe they do.

Senator GORTON. Thank you, Mr. Chairman.

Senator WEICKER. Senator Nickles.

Senator NICKLES. I have a couple of questions. On the disaster payment, I noticed in your statement you said about 20 percent were either delinquent or past due in some way, shape, or form. Is that right?

Mr. BOUCHER. That is right.

Senator NICKLES. That is $1.2 billion. Out of that, do you have any idea how much we might be able to collect? Do you think most of that will be written off?

Mr. BOUCHER. If we are talking about delinquencies, which is separate from what I testified on in terms of excess crop yields, that is a totally separate matter. The $1.2 billion is in addition to what I testified to here.

Of that $1.2 billion, you can automatically forget about getting much back on those loans which are in liquidation. They have gone bad and we are trying to get back as many pennies on the dollar as we can. Out of the $1.2 billion, roughly half.

However, I am not the person to comment. I think SBA's Comptroller or the program officials would be the best people to take a guess as to how much of that we could get back. I would say $500 million to $600, million conservatively.

Senator NICKLES. Therefore, as far as the bad loans are concerned, you are talking about $500 or $600 million in losses. Then as far as the more fraudulent type loans, the excesses, duplications, and whatnot, you used the term hundreds of millions of dollars. All together, you might be talking about as much as $1 billion that might be saved by cleaning up this mess.

Mr. BOUCHER. That is possible, Senator.

Senator Nickles. I have no other questions.

Senator Weicker. Mr. Boucher, your office conducted a number of audits and investigations of borrowers who received SBA farm disaster loans. As part of your review, your office investigated a SBA farm disaster loan received by Thomas E. Davis. What were your findings in this case?

Mr. Boucher. Mr. Chairman, we did make an investigation of Thomas E. Davis of Blakely, Ga. Our investigation was initiated in May 1978 upon receipt of information from the Atlanta district office indicating that Mr. Davis had received duplicate disaster benefits from the SBA and FmHA.

Our investigation disclosed that Mr. Davis received a $330,000 disaster loan from FmHA on January 4, 1978, and the very next day received partial disbursement on an SBA loan of $194,900, all for the same disaster loss. Mr. Davis also failed to disclose the FmHA loan to the SBA and pledged the same collateral to secure both loans.

In addition to the foregoing, Mr. Davis also misused $132,500 of the SBA loan which had a 3-percent rate of interest. He misused the loan proceed when he purchased land, extensively remodeled his personal residence, and placed money in a personal savings account. He was to have used these funds for the farm debt payment and for planting of next year's crops.

In July of 1978, this matter was referred to the Atlanta district office for appropriate action and to the U.S. attorney in Macon, Ga. for prosecutive determination.

I would note, Mr. Chairman, that as required by the terms of the loan agreement, in October of 1978, Mr. Davis sent a check for $16,327 as his first payment on the SBA loan. That check bounced. To date, there have been no payments on the $194,000 SBA loan.

In October of 1978, the district office advised that due to violations of the terms and conditions of the loan agreement, the loan was declared to be in default, and the matter was referred to the civil division of the U.S. attorney's office in Macon, Ga.

In July 1979, the U.S. attorney's office declined prosecution of Davis, apparently in favor of civil action.

These facts were brought to the attention of the criminal division of the Department of Justice in June of 1980. As I understand it, the matter is still under active consideration by the criminal division.

Those are the facts, Mr. Chairman, of the Thomas E. Davis case.

Senator Weicker. Next is the case of Mr. R. V. Segars of Oswego, S.C. What were your findings in this case?

Mr. Boucher. Mr. Chairman, the R. V. Segars Co. was reviewed by the contract auditor whom the SBA Office of Inspector General used. This was not an investigation.

In summary, the facts are that in April of 1978, R V. Segars Co. received a $485,900 SBA loan. As a result of our audit efforts, we found excess crop yields of $73,829. We found that Mr. Segars had misused $55,000 in loan proceeds when he purchased commodities futures through a local stockbroker. We also found that he had duplicate payments of $39.000 from ASCS which he had not reported to SBA.

After issuance of our audit report, SBA made demand for the $39,000 ASCS payment. As I understand it, the borrower is disputing the $55,000 stock deal and the excess crop payments.

We were informed recently that the district office will inform the borrower that based on the audit findings there is prima facie evidence to believe that the $55,000 was used for a stock deal, that he did have excess crop yields, and would shift the burden of proof to him to show that he did not.

I would note, Mr. Chairman, that one of the things we pointed out in our audit report on the misuse of the proceeds in terms of the stock investment is that he received half of his SBA loan proceeds, $242,950, on April 11, 1978. On April 13, 19, and 21, he wrote checks totaling $55,000 to Merrill Lynch. He is going to be given the opportunity to show that he used other funds before we can resolve this particular matter, an opportunity which he did not take advantage of when our auditors visited him.

Senator **Weicker**. What were your findings in the case of Mr. F. W. Meyer of Santa Barbara, Calif.?

Mr. **Boucher**. This was an investigation, Mr. Chairman. It was part of our joint project between the Department of Agriculture and SBA to identify disaster loan recipients who had received duplicate loans from the SBA and the Farmers Home Administration. The investigation was completed in March of 1980.

Our investigation disclosed that Fred W. Meyer, president of F. W. Meyer, Inc., obtained a $70,500 disaster loan from SBA in January 1979 after he had already received approval for and partial disbursement of an FmHA loan of $100,000. Both loans were for the same disaster loss and both carried a 3-percent rate of interest. Mr. Meyer also pledged the same collateral to secure both loans.

In addition to his failure to disclose the FmHA loan at the time he signed the SBA loan agreement, Mr. Meyer further violated the provisions of his contract with SBA when he paid a $33,000 debt to another firm which he wholly owned and made a $10,000 payment to himself out of the disaster proceeds.

The investigation also disclosed errors and omissions in the loanmaking process by both SBA and FmHA.

The facts of this case were discussed on several occasions with representatives of the U.S. attorney's office in Los Angeles. Following these discussions, the U.S. attorney declined prosecution. Some of the reasons cited were that at the time the case did not meet a $250,000 threshold which that office felt it needed to institute a prosecution. The U.S. attorney felt there was an inability to successfully prove criminal intent, and because Mr. Meyer was making payments on his loan, the Government had suffered no loss.

SBA has made demand for full payment. No payment has been made and legal action will be instituted to recover a balance of $62,000 on the SBA loan.

Those are the facts on the Meyer case, Mr. Chairman.

Senator **Weicker**. I might add to my colleagues that as I review these cases, I think they best exemplify the problems we are confronted with. If you have any questions, we will stop case by case for them. Are there any questions on the three cases we have heard so far?

[No response.]

Senator **Weicker**. What were your findings in the case of Harry M. Cook of Talbottom, Ga.?

Mr. **Boucher**. This investigation was part of a joint project between the Department of Agriculture and SBA to identify disaster loan recipients who received duplicate benefits from SBA and the Farmers Home Administration. The investigation was completed in May 1980.

The investigation disclosed that Harry Cook obtained a $91,200 loan from SBA in March 1978 after he had already received a $99,950 loan from the FmHA for the identical disaster loss. He failed to disclose the FmHA loan when responding to questions raised by SBA in the disbursement/settlement process. Both loans carried a 3-percent rate of interest.

Mr. Cook also violated the terms of the loan agreement when he used $45,000 of the SBA loan to pay off a mortgage on his new home.

In August 1980, the Atlanta district director advised the OIG that a demand for full payment had been made. Nearly 1 year later, in July 1981, Mr. Cook paid off the balance of his SBA loan with a cashier's check in the amount of $77,872.

On May 22, 1980, the facts of this case were referred to the U.S. attorney, Macon, Ga. As of this date, we have not been informed of his prosecutive determination.

Senator **Weicker**. Tell us the facts of the case of Leonard M. Smith of Muleshoe, Tex.

Mr. **Boucher**. On January 29, 1980, Mr. Smith of Muleshoe, Tex., received a $500,000 loan from SBA to provide him with $250,000 for crop production expenses and $250,000 for payment of a debt to the Production Credit Association. The rate of interest was 5 percent.

Investigation was initiated in March 1980 after the Lubbock, Tex., district office reported that Mr. Smith had invested $250,000 of the $500,000 SBA loan in a Federal intermediate credit bank bond in violation of SBA loan authorization.

Investigation disclosed that on March 3, 1980, Mr. Smith used the $250,000 authorized for crop production expenses to purchase an FICB bond bearing an interest rate of 15.35 percent. The following day, March 4, 1980, he and his wife certified that they had used the funds as authorized by SBA. Mr. Smith thereafter pledged the bond as collateral for a 12-percent PCA loan which was to be used for farm-related expenses. In effect, Mr. Smith paid only 1.65 percent net interest on a loan of $250,000.

By letter dated June 25, 1980, we urged the SBA district office in Lubbock, Tex., to seek immediate payment. Mr. Smith has acknowledged that he misused the $250,000 of the loan proceeds and has already made $40,000 in payments on this amount.

The matter was also referred to the U.S. attorney's office in Lubbock, Tex., who declined prosecution in favor of placing Mr. Smith in the pretrial diversion program.

Senator **Weicker**. Next is the case of the Dawson Brothers Farms in Hawkinsville, Ga.

Mr. **Boucher**. This was an audit conducted by Ritchey & Co. which was under contract with the SBA Office of Inspector General.

The facts are that in November 1977, SBA approved a $350,000 loan and disbursed equal amounts of $175,000 in November 1977 and February 1978.

The audit disclosed that there was an excess crop yields of $334,000. The predicted loss was $476,901 and the actual loss was $142,889.

Of the amounts disbursed by SBA, $175,000 was placed in a certificate of deposit at 10.25 percent interest, and $25,000 was used to repay a long-term debt as authorized. The Dawson Brothers Farms also received a duplicate payment from ASCS of $10,177 which was not reported.

In June 1981, the Atlanta district office made demand for the $175,000 which was in a certificate of deposit and will also move to reduce the loan balance through repayment of the excess crop yields and duplicate benefits. To date, however, no payments have been received.

Senator **Weicker**. Let me once again just try to get this into focus with the entire loan program. These audits that you are referring to now are part of what sample?

Mr. **Boucher**. These audits are part of only the 438 audits that we did out of the thousands that are out there.

Senator **Weicker**. This is out of the 74,000 that are out there in total. That is, there are 74,000 loans in the portfolio?

Mr. **Boucher**. Yes, sir.

Senator **Weicker**. This sampling that you are referring to in your testimony comes out of an audit, but this is an audit sample of 430?

Mr. **Boucher**. Of a randomly selected 438 loans of $100,000 or more.

Senator **Weicker**. Out of 74,000?

Mr. **Boucher**. Yes, sir.

Senator **Weicker**. Do you think there would be some benefit in expanding the audit sample in light of what you have discussed?

Mr. **Boucher**. I think we could possibly expand the audit sample, but quite frankly I think we could tell the program officials what steps they should take to come up with the same findings we came up with, what records to ask for, what financial statements to require from the farmers. This is only a very limited scope audit.

Senator **Weicker**. How many people engaged in the sampling of the 438?

Mr. **Boucher**. I do not have the figure, Mr. Chairman. It is probably half a dozen.

Senator **Weicker**. The number is certainly a large number and the dollar amount would be even larger, but 74,000 is not an impossible number. What would be required to have a review of all 74,000?

Mr. **Boucher**. I think what I would do, Mr. Chairman, is start with the largest loans. Again, we only looked at 438. In the 24 district offices we picked samples from, there were 5,600 of those size loans. We looked at 438 out of 5,600 loans of $100,000 or more. I would start with those.

Furthermore, as a result of our audit, I think our auditors can tell the program officials, for example, in 1977, crop yields based on our audits were far higher for these particular crops because after you estimated the crop yield and gave the loan, the weather changed. There were windfalls made by a lot of these farmers. We could probably point them in what areas to look specifically.

Senator **Weicker**. I do not think the problem is going to come before this committee again in terms of the mechanism of making the loan. It has now pretty well been turned over to the Farmers Home Administration.

However, neither am I going to go through this record here and suggest that, well, we simply made a mistake. As was correctly pointed out by Senator Nickles, we could be in the area of $1 billion in excess payments. It seems to me that the money ought to be collected.

Certainly on the basis of what I have seen here in terms of your testimony and the small sampling producing these findings, I think every one of these loans ought to be reviewed at this time.

Mr. **Boucher**. In addition to the principal amount, Mr. Chairman, I would also note that many of these are 3 percent loans. We are carrying these 3 percent loans at a time when 3 percent is unheard of. The cost of money is another factor.

Senator **Weicker**. I agree with you. I think we are all well aware of the whole budget process right now. The fact that many people with limited or almost no means are being asked to bear enormous sacrifices when this type of nonsense is continuing makes me think that this is where I would prefer the Government to get its money—not out of some child's luncheon or some old person's home or somebody else's medical care.

Next is the Everidge Brothers Farm of Lilly, Ga.

Mr. **Boucher**. Mr. Chairman, that again was an audit report, not an investigation report. The facts of that particular case are that in January 1978, SBA authorized a loan to the Everidge Brothers farm for $892,300. In April 1978, the loan amount was disbursed. The purpose of that loan amount was stated as $446,150 to pay off a PCA debt and $446,150 for next year's crop production.

Our audit findings disclosed excess crop yields of $413,000 and misuse of proceeds of $446,000. The misuse of proceeds arose, Mr. Chairman, when the borrower used the entire amount of the SBA loan to pay off a pre-existing debt of $940,000 to a PCA. We found duplicate payments of $34,315 which had not been reported to the SBA.

The $446,000 which had been set aside for next year's planting was also lumped together with the first $446,000 to pay off indebtedness to the PCA.

The status of this particular case at this time, Mr. Chairman, is that he will be requested to pay the excess crop yields, and SBA is now holding in abeyance another request for a $206,000 disaster loan from the same borrower. We are told that negotiations are underway.

Senator **Weicker**. They are holding the request in abeyance?

Mr. **Boucher**. He has come back for more money, Mr. Chairman.

Senator **Weicker**. Why do you not just kick him out the door?

Mr. **Boucher**. I guess I could suggest that.

Senator WEICKER. I would.

Next is Autauga Farms of Autauga, Ala.

Mr. BOUCHER. This was an audit, Mr. Chairman. The facts of this particular case are that SBA in October 1979 made a $345,000 loan to Autauga Farms for drought losses. Our audit findings disclosed excess crop yields of $499,526, roughly a half a million.

Let me discuss this for a moment because this is an interesting case in the sense that the SBA loan was based on a projected income loss of $345,000, hence the loan for $345,000. Not only did the borrower have no loss of $345,000, he actually sold his crops for $155,000 more than he had estimated he would sell them for prior to the disaster. Therefore, he had no loss and he also had an additional windfall of $155,000.

The Birmingham district office is going to contact this borrower and make demand for the excess crop yield amounts at least amounting to the SBA loan amount of $345,000 unless the borrower can furnish proof that he had no excess crop yield. In other words, we have shown a prima facie case. We are going to go after the farmer.

Senator WEICKER. I just have two last questions. Then I will ask my colleagues if they have any.

The Federal regulations provide for a penalty of 1½ times the principal amount of the loan if SBA proceeds are misused. Was that penalty applied in any of the cases that you have discussed?

Mr. BOUCHER. It has not been applied in any of the cases which I have discussed, Mr. Chairman. However, as I noted in my statement, serious consideration is being given right now to referring some of these cases, the most egregious cases, to the Department of Justice and working in concert with the Department of Justice to bring a civil suit under that particular provision.

Senator WEICKER. To your knowledge, has this penalty ever been used by SBA on a farm disaster loan where there has been a duplication of benefits or a misuse of proceeds?

Mr. BOUCHER. It could only be used for misuse of proceeds. To my knowledge, it has never gone all the way through the courts. There was one endeavor to use that particular provision. I think suit was dropped before we went to court.

Senator WEICKER. My last question again refers to the area that was initially raised by Senator Rudman. As I understand your response as to why more conclusive results have not been achieved in the justice process, it is that, one, it would be difficult to prove criminal intent, and, two, that there might be as much fault on the head of the agency making the loan as the individual who misused the loan.

Mr. BOUCHER. That is a distinct possibility. I think there are some cases which the Department of Justice can discuss where that was the case. Therefore, they felt it was improper to ask a jury to try to convict somebody when SBA itself had led the person down the path.

Senator WEICKER. Senator Dixon?

Senator DIXON. Mr. Boucher, Production Credit Associations have come up twice in these cases you have talked. Once the Production Credit Association apparently took this farmer and showed him how to manipulate the SBA loan through a variety of contrived schemes and end up paying approximately 1.5 percent on the total loan, all of which of course was ultimately to the advantage of the Production Credit Association that was dealing with him.

On the case immediately prior to the one we last talked about here, you were talking about a Production Credit Association that simply took the SBA money from the farmer as repayment for, I presume, a prior loan they had made him. Is that right?

Mr. **Boucher**. That is correct.

Senator **Dixon**. Let us forget about the "innocent farmer" if that is how this came down in every case in the eyes of the Department of Justice. Here, you are talking about a financial institution, a credit institution, staffed, I am sure, by competent people who are familiar with the money market. What has happened in the case of those institutions as far as the SBA, the Department of Justice, and others are concerned? Those are individuals who know what they are doing.

Mr. **Boucher**. In the one case where the borrower stated that the scenario was prepared for him by the PCA, we referred that particular matter to the Farm Loan Administration which oversees PCA for investigation by them. I do not know what has occurred in that particular case, but we brought it to the attention of the cognizant Federal agency which exercises some kind of oversight over PCA's. However, they are private organizations with a profit motive. I would add that.

Senator **Dixon**. Are they licensed in the States in which they do business?

Mr. **Boucher**. I am not sure of that. I think Mr. Fahey, the next witness, might be able to tell you more about a PCA, Senator. He is the auditor who actually went out there and did the audit work.

Senator **Dixon**. It is interesting to me. If I understand the Chair correctly, you have looked at 5,600 $100,000-plus cases of which you have audited 400-plus of those 5,600 out of 74,000-plus total SBA cases. Is that correct?

Mr. **Boucher**. That is correct.

Senator **Dixon**. Then you have brought to us seven or eight case records to which we have directed our attention and that of the committee. Out of those seven or eight, the PCA has come up twice. I wonder how often that ugly head rears itself in those 400 and some cases you looked at. It looks to me like there is an awful lot of that in these outstanding and very offensive cases.

Mr. **Boucher**. Senator, I wish I could answer your question in more detail. Your point is well made and I believe there is some information which Mr. Fahey can provide to the committee on what he saw as to the role of the PCA's and how they operated out there. He is the next witness, I believe.

Senator **Dixon**. I have nothing further.

Senator **Weicker**. Senator Rudman?

Senator **Rudman**. No questions, Mr. Chairman.

Senator **Weicker**. Senator Gorton?

Senator **Gorton**. I have no more questions.

Senator **Weicker**. Thank you very much, Mr. Boucher. I would appreciate it if you would make yourself available to the committee for some of the subsequent testimony this morning.

Mr. **Boucher**. Yes, sir.

[The prepared statement of Mr. Boucher follows:]

SMALL BUSINESS ADMINISTRATION

Washington, D.C.

STATEMENT OF
PAUL R. BOUCHER, INSPECTOR GENERAL
UNITED STATES SMALL BUSINESS ADMINISTRATION
BEFORE THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

September 9, 1981

Mr. Chairman and Members of the Committee, as you know, I last testified before this Committee on the subject of the Small Business Administration's Disaster Program on May 15, 1981. At that time, I described the past activity of the Office of Inspector General as relates to that Program and outlined some of the management and administrative problems associated with the Program, as well as evidence of abuses and possibly criminal activity developed by our very limited audit and investigative activities.

Seventy percent of all loans made by SBA are disaster loans. SBA now has more than $6.3 billion in disaster loans outstanding. This amount represents 38 percent of all loan dollars outstanding in SBA's loan portfolio. Inadequate staffing in the Program, the only SBA program which relies almost exclusively on temporary employees, underlies many of the serious problems we found. Not the least of these problems is the fact that SBA cannot service its loans or vigorously collect its past due debts.

As a result, $1.2 billion in disaster loans alone is either past due, delinquent, deferred or in liquidation. That amount represents about 20 percent of all disaster loans. In the New York Region alone, approximately 32,000 disaster loans valued at nearly $122,000,000 are in not current status.

The initial Office of Inspector General effort directed toward the Disaster Program was investigative. It began in 1979 when the SBA and the U.S. Department of Agriculture (USDA) Offices of Inspector General matched computer lists to determine the extent to which farmers might be receiving duplicate loans for the same disaster loss from both SBA and the USDA's Farmer's Home Administration (FmHA). Subsequent review of some 1300 loan files disclosed that approximately 119 recipients had apparently received duplicate loans amounting to over $2,000,000. As important as the amount of money involved was our discovery that in some locales SBA and FmHA failed entirely to coordinate their activities, thereby opening the door to fraud and error. This computer match and investigation resulted in the referral of 10 cases to the Department of Justice for possible criminal prosecution. Follow-up action on all these cases has resulted in recoveries of $1.5 million to date in Mississippi, Georgia, Texas, Alabama, New Mexico, Kansas, Iowa and South Carolina, with further recoveries expected.

In July 1980, we recommended a system of cross-agency checks to preclude future large-scale instances of duplicate loans. Our recommendations were adopted and implemented by SBA.

During 1979, the SBA Office of Inspector General hired a small CPA firm to make limited-scope audits of selected disaster loans throughout the United States. The primary purpose of these audits was to determine whether the borrower complied with program laws and regulations and with terms and conditions of the loan contract. The audits also included a limited-scope review of loan servicing practices by SBA.

The audits were made in 24 SBA District Offices in 9 of 10 SBA Regions and primarily covered agricultural disaster loans made from January 1, 1976 through June 30, 1979. A total of 438 loans was subjected to review. Even with this relatively small sampling of loans, the auditors found in the majority of these cases that borrowers had not reported crop yields in excess of the estimated loss upon which the SBA loan amount was based, or had misused the loan proceeds, or had not reported payments from other Federal agencies. Some borrowers engaged in all three practices.

Having said this, let me cover briefly what each of these categories of audit findings means. The most significant finding deals with "excess crop yields". During the period covered by this audit, SBA routinely predicted the eventual loss in crop yields caused by the disaster and used this estimate to compute the amount of disaster loan entitlement. The data used for developing the estimates were usually provided to SBA by agencies of the USDA.

At harvest, if actual crop yields exceeded expectations, or, put another way, the crop loss was not as great as originally predicted, SBA procedures required the farmer to report the actual crop yield to SBA so that the loan balance could be reduced by an amount equal to the value of the excess yield.

By way of illustration, some Georgia farmers were granted loans during August and September 1977 for estimated crop losses on soy beans and pecans. During October and November, prior to harvest, considerable rainfall resulted in yields far in excess of original predictions. In effect, these farmers suffered little, if any, losses on these crops. Relatively few farmers reported these windfalls to SBA. For its part, SBA made no effort to verify ultimate crop yields.

In Texas, the drought caused acres of grazing lands to dry up. SBA made substantial loans to affected farmers for the purposes of re-seeding the pastures. Soon after the loans were made, it rained and the grazing lands recovered. In both these examples, and others, farmers obtained the use of large sums of U.S. taxpayers' money in loans at interest rates of from 3-6 percent for as long as 15 years when they didn't actually need the loans in the amount disbursed, or at all.

Estimating crop losses in the midst of a disaster, is at best unscientific. Furthermore, compensating for predicted losses is in itself a debatable practice. After gaining some experience in what was a new area of disaster lending, SBA recognized these and othe problems and changed its policy in 1978. SBA will now approve no loan until after harvest. This change should largely preclude the problem of "excess crop yields". Our audits disclosed approximately $6.7 million in the category of "excess crop yields".

The next significant audit finding was the possible misuse of loan proceeds. At the time the loans in question were made, SBA regulations specified that no more than 50 percent of the loan proceeds could be used to satisfy pre-existing debts. The remainder of the proceeds was to be used for planting of the next year's crops.

While it is often quite difficult to conclude firmly that a borrower has misused loan proceeds, in many cases the misuse is egregious and blatant. For example, some farmers used the entire loan proceeds to discharge high-interest debts or develop real estate. Other farmers purchased capital equipment to replace similar equipment which was in no way affected by the disaster. Proceeds believed to have been misused were estimated by the auditors at approximately $6.4 million.

The fact that farmers were frequently given unneeded funds which they put in interest-earning instruments for as long as a year was noticed by SBA in 1977. In October of that year, loan procedures were changed to require a showing of immediate need before loan funds were disbursed.

The third audit finding identified the receipt of duplicate benefits from SBA and the Agricultural Stabilization and Conservation Service (ASCS). In brief, ASCS is authorized to make soil conservation grants to farmers who have suffered crop losses. To the extent that these grants duplicate loans made by SBA for the same crop loss, they were to be reported by the borrower to SBA so that steps could be taken to adjust and reduce the loan balance. In some cases, farmers received grants prior to their application for an SBA loan and either falsified their loan application by not reporting such grants, or were not asked by SBA about the grants at the time of application. Audit findings identified duplicate benefits amounting to approximately $2.3 million.

The dollar amounts attributable to these audit findings is significant. As I indicated earlier, a total of 438 loans was reviewed by the auditors. These were randomly selected from a universe of about 5600 disaster loans in amounts of $100,000 or more made by 24 SBA District Offices. These 5600 loans totaled $1.2 billion.

As a result of this process, approximately $169 million in loans was audited. Of that amount, more than $16 million has been implicated within the three categories of excess crop yields, misused proceeds, and duplicate payments discussed above.

Analysis of the audit findings as a whole discloses a distinct geographic pattern. Approximately 195 loans, or 45 percent of the total, were made in offices within the jurisdiction of SBA's Region IV, headquartered in Atlanta, Georgia. That Region's portion of the loans, however, represented nearly $11 million, or 70 percent of the total amount questioned by the auditors. That amount represents $5.5 million dollars in excess crop yields, $3.8 million in possible misuse of proceeds, and $1.7 million in duplicate benefits. At this point, I should note that portions of the southeastern United States which is serviced by Region IV, were particularly severely hit by droughts in 1977 and 1978.

The severe impact of those droughts on the operations of many farmers in the southeast resulted in a great deal of pressure on SBA officials to quickly make loans. What resulted was a process that I have observed in every SBA program about which I, and the Comptroller General, have testified repeatedly. Too much emphasis was placed on delivery of assistance and too little on internal controls and sound management.

As a result, a situation developed in which loans were approved and processed in August 1977 before the first written guidelines could be prepared and sent to the field. In December 1977, the Regional Administrator noted the emergency situation and the need for getting the approved loans disbursed as quickly as possible. In an effort to expedite the process and due to shortages in his legal staff, he authorized loan officers to disburse the loans without prior review by SBA attorneys. He even suggested that the staff work on Saturdays, if necessary, to get the loans disbursed to the applicants.

The pressure felt by SBA at all levels had its desired effect: during 1977-78, thousands of agricultural disaster loans were made by 14 SBA disaster offices staffed by a total of 260 temporary disaster employees. At the present time, the Atlanta Region alone has 47,705 disaster loans valued at $1.5 billion in its servicing portfolio. Of this number, 23,875 are farm loans valued at nearly $1 billion.

I believe that this number is quite significant in terms of any efforts which may be undertaken to recover loan proceeds. For example, our audit disclosed that there are 2640 loans in Region IV which were made for amounts of $100,000 or more. Their total value was $502 million. We selected only 195 of these loans, or 7.4 percent, for audit and linked over $11 million with the audit findings. Any effort to review the remaining 2445 loans, particularly if the review could target those loans made to farmers whom we know had excess crop yields (e.g., in connection with soy bean or pecan harvests), would suggest the possibility of perhaps as much as $100 million more in potentially recoverable loan proceeds. This does not take into account the additional thousands of loans made to farmers for amounts of less than $100,000, many of whom may well have had similarly higher crop yields, received duplicate benefits or misused loan proceeds.

The Office of Inspector General informed the Regions covered by this audit activity of its preliminary audit findings. We asked that they initiate appropriate action to recover loan proceeds relating to our audit findings. To date, in Region IV alone, SBA has either recovered or received agreements to pay back funds from borrowers which total $1.5 million, an additional $1.4 million has been demanded from borrowers by the SBA. I think it is significant to note that the audit activity which triggered these and future collection efforts cost the SBA Office of Inspector General approximately $245,000 -- an excellent return on the use of contract funds.

At the same time that some recoveries were made, some Regional and District officials inquired as to the legal grounds for recovery of funds associated with the audit findings.

The Office of Inspector General requested that program officials work with District and Regional SBA attorneys to discuss any legal issues and devise feasible collection methods. Concurrently, this Committee began to express an interest in SBA's disaster operations, including the issue of legal remedies. On July 30, 1981, I requested that the General Counsel's Office review the issues involved in our audit findings, and identify practicable and effective legal remedies to guide the Agency's collection efforts.

Since that request, we have engaged in discussions with representatives of the Office of General Counsel on a number of issues related to SBA's ability to collect excess crop yield funds, duplicate benefits and misused proceeds. It is my understanding that the General Counsel is developing a plan of action for institution of collection procedures against borrowers to recover amounts associated with excess crop yields, duplicate payments and misused loan proceeds. These actions will follow a review of the audited loan files and the development of additional information on the thousands of other borrowers who received SBA assistance. Actions which are expected to result include negotiation of voluntary agreements by borrowers to repay overpaid or misused funds, acceleration of entire amounts of indebtedness, and coordination with the Department of Justice for the purpose of initiating actions to impose civil penalties for misuses of loan proceeds. My Office will be following up in the coming weeks and months to evaluate SBA's progress in these recovery efforts.

Based on the results of our limited audit activity, I believe that the findings of non-compliance can be attributed to the activities of both SBA and those farmers who received SBA assistance. The disaster loan program relies heavily on voluntary compliance with the terms of the loan agreement and authorization by farmers and other borrowers. Again, this is partly the result of a history of inadequate staffing to properly service a loan portfolio in a program which places greatest emphasis on the rapid delivery of assistance to a large number of borrowers in times of crisis or tragedy.

I think that one example of the type of difficulty facing SBA managers can be illustrated by a letter recently received by the Office of Inspector General from the SBA District Director in Columbia, South Carolina. In responding to our requests that action be taken on our audit findings, he wrote, in part:

> "Presently we have four loan officers to serve approximately 3,000 business disaster loans and with the proposed cutback by the end of September, we will have only two. We need a minimum of ten to adequately service these loans. To follow-up on actual or potential violations would require an even larger staff."

I hasten to add, however, that despite the lack of personnel resources, the District Director has still attempted to mount an aggressive effort to correct deficiencies, has made demand for repayment from SBA borrowers and, in fact, has already recovered more than $580,000.

At the time that our audit and investigative activities were being carried out, the Inspector General's Advisory Council was preparing its first report. That report, which covered all aspects of SBA's Disaster Program, was released in May 1981. It detailed a variety of problems and recommended solutions based on the viewpoints and the experience of the professional SBA employees who served on the Council. The views in the report are those of SBA employees who have been making a sincere effort to make disaster operations work. Their criticisms reflect the frustrations encountered in years of making that effort. The report offers another perspective on the problems in disaster lending operations that our audits and investigations have brought to the fore.

The Council made several major recommendations for improvements including:

- upgrading the Office of Disaster Operations to a major SBA division headed by an Associate Administrator;
- hiring 5 area managers to direct an expanded 500-person permanent disaster cadre;

- revamping disaster declaration criteria to make sure that disaster assistance goes to the truly needy and does not merely compensate for insurable or predictable business risks;

- strengthening collection procedures to reduce the nearly $1.2 billion in disaster loans which are past due, delinquent or in liquidation;

- improving guidelines for surveys, loss verification, and loan processing to reduce fraud and error;

- simplifying loan forms and make other improvements to resolve the vulnerability of disaster victims to con artists;

- beginning systematic contingency planning to prepare for disasters instead of merely reacting to them.

Administrator Cardenas has personally reviewed the Advisory Council report and I believe he is prepared to adopt a number of the recommendations contained therein. I believe that the Advisory Council concept has proven itself to be an effective means for giving concerned employees a place to make frank criticism of stated Agency policy and practice without fear of reprisal.

I fully expect to have a second Council formed early in the new fiscal year. This Council will study SBA's loan making, loan servicing and loan liquidation practices. It will study, criticize where necessary, and make recommendations designed to improve SBA's debt collection activities. I would note that the response of SBA employees to our call for volunteers has already resulted in more than double the number of volunteers for the first Council.

Based on our limited audit activity, and in an effort to supplement those of the Advisory Council, I would offer the following interim recommendations for consideration by SBA officials responsible for its disaster lending programs and, where appropriate, by Congress.

Initially, under no circumstances should the SBA disburse the proceeds of any loan absent a review of the legal sufficiency of the entire loan package by an SBA attorney.

Additionally, consideration should be given to inclusion of a provision in all disaster loan agreements which would permit SBA to adjust the interest rate on the loan upon its determination that certain conditions have occurred: e.g., misuse of loan proceeds, or failure to apply excess loan amounts to reduce the outstanding loan balance. In effect, I am suggesting that to the extent that a borrower has not complied with certain terms of the loan agreement, the borrower should not be allowed to continue to enjoy the very same favorable interest rates as those who have abided by their agreements.

For example, consistent with practices which apply in the private sector, SBA could have the authority to call a note for the purpose of re-negotiating the interest rate to one more closely approximating, at a minimum, the cost of money to the Government. Particularly in cases where misused or excess amounts could not be immediately recovered by the Government without the relatively more drastic consequence of a foreclosure, this provision could be considered as an interim measure which would reduce or eliminate the amount of the interest subsidy being paid by the Government. Those who might consider this proposal to be unduly harsh should bear in mind that the borrower would continue to have the use of funds at favorable rates over those of the commercial market and still avoid the immediate and drastic results of a Government foreclosure action.

In the same vein, a recurring issue raised by members of the Inspector General's Advisory Council, as well as others experienced in loan servicing, relates to the very liberal deferment practices which have been followed by SBA. I would suggest that our deferment policies be reviewed. In an effort to discourage requests for unnecessary deferments and to remove from SBA some of the burden of making a judgment on the merit of a deferment, SBA might consider adopting measures which would permit it to incrementally raise interest rates on amounts carried in a deferred status. This proposal, I believe, would require amendment of the Small Business Act provision dealing with such deferments.

If this is not feasible, at a minimum, SBA should develop guidelines which would require clear and convincing evidence that a deferment is clearly warranted.

I referred at the outset of my testimony to the New York disaster loan situation. The handling of the problem in New York City alone has resulted in some rather innovative and successful action by the District Director and his staff. In effect, he has begun a well publicized crackdown on individuals who are delinquent on home disaster loan payments. Through close coordination with the U.S. Attorneys' offices in the Eastern and Southern Districts of New York, and person-to-person visits with borrowers, nearly $1.3 million has been collected from previously delinquent borrowers over a six-month period of time. The District Director predicts that these collection figures can be doubled in the next six months. While not in any way related to agricultural disaster loans, I believe that the New York experience demonstrates what can be done, even with limited resources, when there is effective inter-agency coordination and a commitment to a vigorous program of debt collection.

On the general subject of debt collection, I would like to offer my general comments about the Government's practices in this area.

An individual's good credit rating is generally a most valued possession. In the past, Government agencies have been unable to take part in a process widely used and heavily relied upon in the private sector. I refer to the practice of reporting to credit agencies those individuals or firms which have not lived up to their financial obligations. Just the threat of a report is often enough to encourage efforts by debtors to settle accounts with creditors. I generally support legislative initiatives reflected in several recent bills, particularly S. 1249, presently pending in the Senate, which would permit Federal agencies to provide reports on its debtors to credit reporting agencies.

In discussions with the Committee staff prior to this hearing, I was asked to make any suggestions or recommendations which I believed might address some of the problems discussed here. I would offer the following for the Committee's consideration.

In looking at Government-sponsored programs, we often view them as services provided by a number of unrelated organizations with little, if any, demonstrable connection with one another. This perception is only underscored when we discover duplicate and overlapping programs within the executive branch. Improved inter-agency coordination is essential if we are to identify areas of exploitable weakness and consolidate our efforts. In this respect, I believe the Government ought to consider the feasibility of establishing a system which would allow the various departments and agencies to deny or adjust succeeding requests for financial assistance to an applicant who has not had a satisfactory record with another Federal agency or agencies.

For example, in the case of farm disaster loans, the SBA should use all currently available resources to collect misused, excess, or duplicate funds in the hands of borrowers. To the extent that we are able to demonstrate the existence of these windfalls but are not able to recover them, some consideration should be given to development -- either by statute or regulation, if possible -- of uniform interagency set-off procedures. Applied to the current situation, a farmer applying for disaster assistance from FmHA in the future might have his or her entitlement amount adjusted on the basis that assistance had been received from another agency -- in this case, SBA -- which proved to be in excess of the loss suffered.

As I noted, this would require effective coordination among all Government agencies involved in granting financial assistance. Precedent for this may be found in the processes which now exist with respect to debarred and suspended contractors. This system is now in the process of being improved and augmented so that it can be used more effectively to protect Government agencies from inadvertently contracting with an entity which has been debarred or suspended by another Federal agency.

The effect of any such system is the recognition that individuals dealing with the Government deal with a cohesive entity, and not a group of unrelated agencies with little, if any, relationship to one another.

While these practices would be new to the Government, especially those dealing with debt collection and credit reporting practices, their adoption would do nothing more than place the Government on a similar footing with the private sector whose commercial lending practices and debt collection measures are well known to all individuals. Failure to pay on just debts yields a certain result in the private sector; that result should be no less certain when the Government is the creditor. The mere knowledge that the Government will take action will often provide sufficient incentive to most individuals to make required payments.

Adoption of such measures as these would, I hope, re-structure a system which in effect has penalized the vast majority of Americans who are conscientious about fulfilling their obligations and responsibilities after the Government has used the taxpayers' money to provide assistance to them.

Mr. Chairman, that concludes my prepared statement. I would be pleased to answer any questions you may have on my testimony.

SBA

U.S. Small Business Administration
Office of Inspector General

Report of the Inspector General's Advisory Council on SBA's Disaster Operations

May 1981

U.S. Small Business Administration
Washington, D.C. 20416

OFFICE OF THE
INSPECTOR GENERAL

Honorable Michael Cardenas
Administrator
U.S. Small Business Administration
Washington, D. C. 20416

Dear Mr. Cardenas:

The Inspector General's Advisory Council was formed in order that this Office could fulfill its responsibility to management in making recommendations to protect the Small Business Administration's programs from waste and abuse in addition to improving their economy and efficiency. For these purposes, the people best qualified to evaluate individual programs are those who know them best: SBA employees experienced in the day-to-day operations of the program being evaluated.

This Report on SBA's Disaster Operations highlights and presents practical, effective solutions to those problems which the Council members view, from their experience, to be persistent and significant deficiencies in this program. Some of the solutions to the problems identified may not be easily implemented and will require a major commitment by the Agency and program officials to improve the program. We feel, however, that the importance of the Disaster Lending Program, which represents a major portion of SBA's loan portfolio, requires that serious consideration be given to addressing the concerns voiced by those highly qualified and motivated personnel who have served on the Council.

I would like to extend my contratulations and appreciation to the individual council members for their work, which was done in addition to their regular duties, as well as commend them for a job well done. Each and every one of them is a credit to the Small Business Administration. The former Administrator, A. Vernon Weaver, the Regional Administrators and District Directors who supported the initial concept of the Advisory Council and who assisted the members in producing this report, also deserve recognition. In addition, I note with appreciation that the current Administrator, Michael Cardenas, has pledged continuing support for the Advisory Council with the belief that the work of the Council will assist SBA's management in improving program operations.

Sincerely,

Paul R. Boucher
Paul R. Boucher
Inspector General Designate

MEMBERS
INSPECTOR GENERAL'S ADVISORY COUNCIL

Thomas V. Amico
Loan Specialist
District Office
Philadelphia, PA

George Darby
Regional Disaster Coordinator
Region VI
Dallas, TX

John Fall
Branch Manager
Disaster Branch Office
Lubbock, TX

Susanne Gruber
Public Information Officer
Region VII
Kansas City, MO

J. Gail Houck
Chief, Portfolio Management Div.
District Office
Dallas, TX

Leon Kessler
Loan Specialist-Group Leader
District Office
Hartford, CT

Joe Meyer
Economic Development Specialist
District Office
New York, NY

Richard A. Schulze
Representative-in-Charge
Post of Duty
Tucson, AZ

C. Raymond Shaw
Loan Officer
Portfolio Management Division
District Office
Jacksonville, FL

Mervyn Shorr
Disaster Coordinator
Region II
New York, NY

Harold Wakehouse
Loan Specialist
Finance Division
District Office
New York, NY

COUNCIL COORDINATOR:

Robert D. L'Heureux
Special Assistant to the Inspector General

TABLE OF CONTENTS

Page

I. Introduction and Executive Summary 1

A. Introduction 2

B. Executive Summary. 5

II. Policy and Organization. 8

A. Central Programmatic Responsibility and Authority. 9

B. Field Delivery Options 11

1. Area Concept 14

2. Regional Concept 19

3. District Concept 22

III. Program Operations 24

A. The Disaster Declaration Process: Disaster Criteria. 25

1. Physical Disasters 25

2. Economic Injury Disasters. 29

B. Disaster Surveys 31

C. Loan Screening 34

D. Loan Processing. 36

E. Loan Servicing and Collection. 38

F. Communication with the Public. 40

G. Liaison with Other Agencies. 42

H. Fraud, Waste and Abuse 46

1. Eligibility Claims 46

2. Loan Packagers 48

3. Misuse of Loan Proceeds. 50

4. Fraudulent Contractors 52

Page

IV. Program Administration 54

A. Personnel Staffing: Sources, Grades and Staffing Plans 55

B. Use of Overtime. 63

C. Performance Evaluation 65

D. Per Diem/Subsistence Allowances. 67

E. Budget and Cost Management 69

F. Procurement of Office Space. 72

G. Other Procurement Issues 75

H. Interaction with Other SBA Departments 77

I. INTRODUCTION AND EXECUTIVE SUMMARY

A. INTRODUCTION

This report is the result of a study made by the first Inspector General's Advisory Council within the SBA. The Advisory Council, a stated priority of the Office of Inspector General, was designed to provide a mechanism for experienced field employees both to advise the Inspector General on problems within program areas and to propose practical solutions to those problems.

Development of the Council began with a letter addressed to all SBA employees in November 1979, which explained the Council, its functions, operations, and study target: disaster operations. SBA staff, both permanent and temporary , were asked to send a resume of disaster experience if they were interested in Council membership.

Subsequently, the Office of Inspector General sent a questionnaire to all respondents requesting comments on a number of disaster program areas. Selection of the Advisory Council members followed an evaluation of applicants' experience and responses to the questionnaire.

Council members came from 9 of the 10 SBA Regions and possesses an average of about 10 years of experience with SBA, much of it in disaster work. Four of the fifteen members selected were disaster temporaries at the time of their appointment to the Council. Most of the members have served in various capacities with SBA, some in managerial positions.

After Council members were notified of their selection, they were sent additional information on new issues raised in preliminary questionnaire responses. They were then asked to consult with their local staff regarding these issues prior to the first Council meeting. This meeting was convened in Silver Spring, Maryland, May 28 and adjourned May 30, 1980. During this week, Council members developed a study agenda, established three subcommittees, made study assignments and set deadlines for completion of preliminary reports.

In the course of the next several months, individual members conducted research and prepared discussion papers for submission to their respective subcommittee. The papers were circulated among the subcommittee members, refined to reflect subcommittee consensus and then distributed to all Council members for study prior to the next meeting.

The second meeting was held October 27 through November 1, 1980, in Dallas, Texas. At this time, the Council considered all discussion papers and revised them to reflect broader areas of agreement.

It was decided by the Council that the Final Report should include all points of view where unanimity did not exist among the members. It should be noted, however, that consensus was generally reached quite quickly.

In the view of the Council, the problems within the disaster program are recurring, systemic difficulties which are rooted in the basic priority, structure and organizational design of the program. Council members, professionals who have worked for years to adapt the system to meet the needs of disaster victims, were quick to identify issues and surprisingly unanimous in proposing solutions to the problems.

The following report does not purport to be a comprehensive treatment of SBA's disaster operations. Rather, we have concentrated upon those areas which our experiences and those of our colleagues have told us were the basic issues. Our solutions are practical approaches, but require a major commitment by the Agency to recognize the depth and breadth of the disaster problem.

We of the Council applaud the Inspector General's initiative and the Agency's willingness to support the Council. We also appreciate the time and interest shown by Regional Administrators, District Directors, supervisors, and program officials at all levels. We have dealt openly and candidly with issues that deeply concern us regarding the disaster program and it is our hope that SBA management will note and heed these concerns.

B. EXECUTIVE SUMMARY

At the end of Fiscal Year 1980, there were over 322,000 disaster loans outstanding having a value of $5.4 billion. These loans represent over 70 percent of the total SBA loan portfolio. Of the total number of SBA loans approved during FY 1980 alone, 70,000 were disaster loans in the amount of $1.2 billion, or 69 percent of the Agency's portfolio for that year.

For FY 1980, 13 percent of the Agency's Salary and Expense Budget was charged to disaster activities. The disaster program typically employs at least 920 temporary staff with a great many permanent staff assigned to it in varying capacities. The 13 percent expenditure for the Agency's disaster activities does not include a factor for time and expenses incurred by the permanent employees who were engaged in disaster-related work.

Beyond the sheer dollar magnitude of the disaster program, which would in itself indicate that this program should be considered a major priority within the Agency, the program has an enormous impact each year on individuals and communities across the country. Despite these factors, the disaster program seems to have been relegated to the lowest Agency priority. On a national level, it is buried deep within the organizational stratum. In the field, the program operates through a maze of confusing and conflicting lines of authority.

Our first recommendations, therefore, regarding Policy and Organization, address the issues of national program authority and the field delivery systems. We believe the confusion surrounding these two issues has been responsible for the operational and administrative difficulties we have identified.

First, we recommend that the importance of the disaster program be acknowledged through the establishment of a major division fully responsible for its implementation, headed by someone at an Associate Administrator or comparable level reporting directly to the Deputy Administrator.

Second, we urge the adoption of the Area Concept for field program delivery, established in a manner consistent with that described in this report. Under this concept, Area Managers reporting directly to an Associate Administrator would be fully responsible for the planning and delivery of disaster services.

These two basic recommendations facilitate the implementation of a number of operational improvements. Most important among these is the need to reconsider the entire framework of disaster declarations. We suggest that the Agency separate genuine disaster conditions from events which are more validly considered business risks or insurable losses. Limited financial resources must be directed toward the areas of greatest need.

A number of other operational improvements which are urgently needed are:

(1) Disaster surveys which are conducted expeditiously, accurately and professionally. Information thus obtained could be used for loan and operating funds estimates, including staffing and space requirements.

(2) Effective, timely loss verifications which would expedite loan processing and reduce the possibility of false eligibility claims.

(3) Simplified application forms which would aid disaster victims and staff alike. This should also reduce the need for outside packagers to complete the forms.

The major recommendation contained in the Program Administration section of this report is to suggest that the Agency develop contingency methods in planning for funding and staffing needs. Many of the staffing and administrative difficulties identified in this section would be resolved by the creation of adequate field delivery systems.

II. POLICY AND ORGANIZATION

A. CENTRAL PROGRAMMATIC RESPONSIBILITY AND AUTHORITY

Problem

The Office of Disaster Operations (ODO) lacks the authority necessary to carry out the disaster program.

Discussion

Historically, the disaster program has been regarded as a program that was constantly interfering with the Agency's "real" mission. Probably for this reason, the disaster program has been a low priority within the Agency. ODO has minimal staffing, little authority, and even less voice in policymaking. The Director, ODO, reports through an Associate Administrator and an Assistant Administrator before getting to the Deputy Administrator and the Administrator.

During FY 1980, disaster loans accounted for 69 percent of the Agency's total loan approvals. At the end of FY 1980, disaster loans represented 70 percent of the total number of loans held in the SBA portfolio. In terms of personnel resources, the disaster program typically employs at least 920 temporary staff at any one time.

The disaster program, as these figures signify, is far too important to the overall image, effectiveness and success of the Agency to be relegated to a fifth-line level of management. The disaster program was assigned to us by Congress and until such time as it is removed from our mission, it deserves our proper attention. The recent reorganization of the program into an Office of Disaster Policy and Office of Disaster Operations, does not in itself serve to elevate disaster operations to an effectively high level of management.

Recommendation

The magnitude of the disaster loan program should be acknowledged through the establishment of a major division fully responsible for its implementation, headed by an Associate Administrator who reports directly to the Deputy Administrator, as was recommended in 1978 in the Omnibus Small Business Act, H.R. 11445.

INTENTIONAL
BLANK

B. FIELD DELIVERY OPTIONS

Problem

Disaster services now form a patchwork of varying and frequently inconsistent response methods, management styles, levels of efficiency, and interpretation of program guidelines. Typically, provision of services falls to the District Director, who is neither trained nor experienced in disaster work. Furthermore, District Directors are not evaluated for their proficiency in disaster operations.

Discussion

SBA was initially pressed into disaster service on the theory that it was a widely dispersed Federal lending agency. Since then, a number of ad hoc systems for disaster response have been experimented with, all unsuccessful in the most important respects.

The current system illustrates the problems in disaster management. Present organization calls for a Disaster Coordinator in each Regional Office and the responsibilities of these coordinators, where defined, not only vary from region to region, but at times may actually vary from one disaster to the next within the same region.

Regardless of the current theoretical structure of the disaster program, the District Director usually becomes the responsible official for the management and delivery of disaster services in most regions. The maintenance of any system which leaves the management of disaster delivery services to District Directors must of necessity suffer from conflicting goals and objectives.

Disasters are episodic and catastrophic, thereby requiring implementation of the disaster program on an intermittent and urgent basis, which is unlike any other SBA program. Disaster lending involves mass volume, short-time processing and real estate repair lending to individuals. These characteristics of the program ordinarily fall outside the experience, training and expertise of most District Directors.

District Directors are not selected, trained, nor evaluated with respect to disaster goals and objectives. The time they spend on disasters is likely to act against the accomplishment of other, bonus-related goals and objectives. The FY 1980 Regional Operating Plan contained only scant mention of disaster service delivery in its dissemination of national SBA directional guidance, reflecting the low Central Office priority attributed to this program.

Where disasters are common, District Directors tend to become quite efficient at responding to them. For the most part, however, disasters do not occur with such frequency so as to maintain local expertise. Consequently, there are recurrent problems with over- and under-staffing of temporary employees, interpretation of regulations and SOP's, loan processing and administrative support. Some of this may be due to the inadequacy of disaster management controls such as regulations and SOP's.

Recommendations

The following is a discussion of three options for field delivery systems for disaster services, presented in the order of their recommendation. The Advisory Council believes (with one member not concurring) that the Area Concept (Option One); i.e., placing full authority and responsibility for delivery of disaster services in an Area Manager and not the Regional Administrator and District Director, is the preferable choice. The one member not concurring believes that the District Director should retain ultimate authority and responsibility.

1. Area Concept

The Area Concept would establish a direct line of accountability for disaster operations alone. The Council recommends that five areas be established. This organizational structure recognizes both the magnitude and the uniqueness of disaster operations, including unpredictability, mass processing, the need for immediate response to victims, and lending to individuals for home repair. These features fall outside the background and orientation of most Regional Administrators and District Directors.

Operating features of the Area Concept are as follows:

(a) The five Area Managers would report directly to an Associate Administrator for Disaster Operations in the Central Office. They must coordinate closely with Regional Administrators and District Directors in both contingency planning and operational matters.

(b) Area Managers and key staff should be employed exclusively for the purposes of disaster planning and delivery.

(c) Area Managers would have responsibility for contingency planning goals and objectives for program development and maintenance as well as for liaison with other agencies.

(d) Disaster cadre personnel would provide the nucleus of a Disaster Office to be deployed at the direction of the Area Manager.

(e) Area Managers would be responsible for staffing and administration of all physical disasters, Presidential and Agency declared, of whatever magnitude.

(f) Area Managers would have full hiring and procurement authority, with training and staffing to carry out that authority.

(g) When a large scale disaster is declared, and conditions warrant, the Area Manager would establish a full-scale office to handle all disaster lending. Cadre members would train staff in each function. Thus, most staff would be hired locally which would require only a few cadre personnel to be on per diem status.

(h) When a lesser disaster is declared, and the case load does not warrant establishment of a full-scale office, the Area Manager would establish a screening office at the disaster site. Loan applications would be sent to the area office for processing and disbursing. This type screening system has been used effectively in several Midwest locations during 1973 and 1977.

(i) District Offices would retain responsibility for non-physical disasters, but could request assistance from the Area Manager where circumstances require additional expertise and resources.

Advantages of Area Concept

(1) Routine functions of already overburdened District and Regional offices would be prevented.

(2) Provides specific disaster-oriented goals and objectives to full-time staff.

(3) Provides goals, objectives, and resources for contingency planning for disasters.

(4) Maintains trained staff for immediate response to a disaster declaration.

(5) Can reduce per diem costs with effective use of cadre personnel and simplified processing.

(6) Provides a greater degree of consistent application of disaster regulations to victims.

(7) Provides constant, consistent liaison with FEMA, State, SBA and other officials for planning and operational purposes.

Potential Difficulties with Area Concept

(1) Establishes a parallel structure to the District Director apart from the present, decentralized chain of authority.

Response: Such a parallel structure is required because disaster operations are very different from routine SBA operations.

(2) Removes authority and ignores the liaison already conducted by the District Directors during disasters. In addition, it produces the possibility of confusion by State and local officials, and victims.

Response: Whether by direction of the Regional Administrator or lack of expertise in disaster work, many District Directors essentially have failed in the past to exercise full authority in the administration and conduct of disaster operations. The Area Manager would coordinate fully with the District Director in contingency planning, which would include the introduction of the Area Manager to local officials. The District Director could also easily assist in the liaison process and direct victims to the Disaster Office.

(3) Results at times in "passing off" disaster-related loans to District Offices for servicing when the District Offie was not involved in processing the loans.

Response: This particular effect occurs in some Regions under the present system. If some other method of servicing all disaster loans were adopted, this difficulty could be eliminated.

2. Regional Concept

Under the Regional Concept, each Region would have a full-time Disaster Coordinator (RDC) to manage regional disaster operations. Other elements are:

(a) Proposals vary on whether the RDC would report directly to the Regional Administrator or to ODO.

(b) In historically active Regions, RDC's would have permanent cadre support staff, with other permanent cadre staff also based in those areas for loan to Regions with only intermittent demand.

(c) RDC's in Regions less active in disaster related work would rely on regular support staff in the Regional Office.

Advantages of the Regional Concept

(1) Responsibility for the coordination of disaster operations would be clearly placed with the appointment and delegation of authority to the RDC's.

(2) If RDC's reported directly to the Regional Administrators, it would upgrade the relative importance of the function and encourage more immediate response from other SBA staff.

(3) As part of the Regional staff, RDC's should be sensitive to the needs, relationships, and resources existing within the Region.

(4) There may be cost savings realized, if a Region-wide loan processing center were established, using smaller screening offices in smaller disasters.

Potential Difficulties with the Regional Concept

(1) There are problems inherent in either of the proposed reporting lines. If the RDC reports directly to the Regional Administrator, she/he is subject to all the present pressures of trying to run a low-priority program. On the other hand, RDC's reporting directly to ODO would probably encounter real problems working with and through local staff with different priorities.

Response: One of the problems with the present disaster system is that field Disaster Coordinators have no support staff from which to draw. Many RDC's in this proposal would face the same situation and would be required to rely upon people with full-time responsibilities in regular program areas.

(2) What would full-time coordinators do in Regions with little disaster activity?

Response: RDC's would either carry collateral assignments, and thus have a conflict when disasters occurred, or they would be available for work in other Regions, which make the Regional designation unnecessary.

3. District Concept

Operating disasters on a district basis would combine the existing district delivery method with cadre members being available for major disasters. Their presence would, presumably, be at the request of the District Director. Where available, cadre members would be the core of Disaster Offices, supplemented by temporaries as needed.

Advantages of District Concept

(1) The provision of a core of permanent trained staff for major disasters. (One must note, however, that this is due to the existence of the disaster cadre rather than any particular merit of the district concept.)

Potential Difficulties of District Concept

(1) The concept's operation is not clear, but it appears to vacillate between having everyone operate disasters and having no one really responsible. It is not clear whether ODO would be setting up and running all major disasters or if Regional Administrators and/or District Directors would be responsible, and request ODO support.

Response: This may even be worse than the present system in that not only would Regions and Districts both run disaster operations; the Central Office would be involved as well.

(2) Disruption of District operations would still be a strong factor. If ODO staff would be available only for major disasters, who would run the smaller ones? Who would organize major disaster operations if Districts chose not to request ODO assistance?

Response: Disruption of local operations and interference with accomplishment of MAC program goals is a major problem now that would continue under this plan.

(3) As ODO staff would be in and out of the disaster area (or not in at all), what would ensure uniformity of interpretation of loan guidelines?

Response: This is one of the thorniest problems we face now.

(4) There does not seem to be any cost-cutting result in this concept. Individual Disaster Offices would still be established for each disaster.

Response: Since Salary and Expense funds are harder to get each year, this is a major problem.

III. PROGRAM OPERATIONS

A. THE DISASTER DECLARATION PROCESS: DISASTER CRITERIA

Problem

Existing criteria leading to the designation of geographic areas as either a physical or economic injury disaster area are too broad.

1. Physical Disasters - Discussion

The variety of events which may lead to an SBA physical disaster declaration has grown throughout the years. At present, SBA makes disaster declarations for floods, hurricanes, tornadoes, earthquakes, fires, drought, riots, too much or too little snow, and other reasons. Under the 7(b)(9) Economic Dislocation Program, any number of natural or man-made events can lead to a disaster declaration.

Events listed above must have the following impact to lead to a physical disaster declaration by SBA:

(a) At least 25 homes or 5 businesses, or a combination of at least 25 eligibles in any country or other political subdivision, collectively have sustained uninsured losses averaging 25 percent or more of their estimated fair replacement value; or,

(b) At least 3 businesses have sustained uninsured losses averaging 25 percent or more of their estimated fair replacement value and 25 percent of the work force in the community would be unemployed for at least 90 days as a direct result of the physical damage; or,

(c) At least 200 homes or 40 business concerns, or a combination of 200 eligibles in any county or other political subdivision, collectively have suffered any loss as a direct result of a physical disaster.[1]

---

[1] A recent change to the regulation establishing these criteria has been made by SBA. While supporting the need for change, the Advisory Council prefers the recommendations made herein. It will comment separately on the new regulation.

Recommendations

(Physical Disasters)

There are several issues to be addressed here:

(1) Do physical disaster declarations need to be available to cover a wide number of contingencies which might otherwise be subsumed within available hazard insurance or a general risk of doing business? The Council suggests the events for declaring a physical disaster be restricted to the following:

(a) Natural disasters, such as earthquakes, hurricanes, flooding, tornadoes, etc.

(b) Riots.

(c) Fires (in areas where insurance was not available or where the cost would be prohibitive).

(2) Are eligibility criteria for physical loss set too low; thereby allowing many relatively minor occurrences to be declared as physical disasters? The recommendations of the Council are as follows:

(a) Revision of the first element of the physical disaster loss criteria (designated "(a)" on page 28), to read: "At least 50 homes or 10 business concerns or a combination of 50 eligibles in any county or other political subdivision, collectively have sustained uninsured loss averaging 25 percent or more of their fair replacement value."

(b) The criteria designated (b) and (c) could remain the same.

(3) Should adjacent counties always be included in declarations of disaster?

(a) The Council would like to recommend that the policy of automatically including adjacent counties be revised. An adjacent county, in our view, should only be included when it has suffered related damage arising from the same disaster, and only when such inclusion is recommended by the disaster survey team.

2. Disaster Criteria: Economic Injury Disaster Loans

Discussion

The Economic Injury Disaster Loan Program (EIDL) may also be declared operational after a physical disaster as a result of a Presidential declaration, SBA declaration, or declaration made by the Department of Agriculture. As adjacent counties are automatically included in any physical disaster declarations, and because EIDL may become operational after such a physical disaster declaration, it would also extend to adjacent counties. We believe that this program should also be extended to adjacent counties which have suffered damage relative to the same disaster and only on the recommendation of the disaster survey team.

Economic injury, aside from that related to physical damage, should be confined to businesses suffering due to the imposition of new Federal laws and regulations. Most other conditions should be considered the risk of doing business, particularly those businesses dependent upon natural conditions whose owners knowingly assume the inherent risks involved. The Federal Government should have no involvement in the normal risks of entrepreneurship.

Recommendations

(1) The following are the only two categories of non-physical disaster loans the Council would recommend:

(a) Economic injury directly resulting from physical damage (following the physical disaster guidelines set forth above) and the resultant business curtailment;

(b) Economic injury resulting directly from federal laws such as the Clean Air Act or the Wholesome Meat Act.

(2) Before an EIDL declaration has been made, guidelines should be specific for measuring the amount of the economic injury and the time period to be allowed for the recovery.

(3) Extension of EIDL benefits to adjacent counties should be done only in cases where those counties have suffered economic damage which directly relates to the nearby physical disaster area; and, only on the recommendation of a disaster survey team.

B. DISASTER SURVEYS

Problem

There is a lack of consistency in both the methodology and quality of disaster surveys.

Discussion

Accurate, prompt projections of damage to homes and businesses are extremely important tools in providing information on the size and scope of a disaster. When conducted properly, survey information can be used to plan for loan fund and staffing needs, space requirements, and other Salary and Expense needs.

At the present time, Regions and Districts employ a variety of survey methods. Some areas do nothing more than have a District Loan Officer contact several bankers to ask about the extent of the damage. Other areas call local law enforcement agencies for estimates. Still others call upon the American National Red Cross (who never survey business or farm loss). In only one or two Regions are SBA Disaster Loss Verifiers used for survey purposes. It is clear that home loss surveys conducted by people without construction or appraisal backgrounds may not be particularly accurate. As a result, we have inadequate information for use in staff planning and the projection of fund-requirements.

Recommendations

A basic survey requires an expeditious, accurate, and professional approach. In order to standardize our methods and upgrade the skill levels of those conducting surveys, we suggest the following:

(1) SBA disaster surveys should be conducted only by experienced, qualified SBA Loss Verifiers who are part of the disaster cadre.

(2) When an obviously major disaster occurs, SBA should dispatch a survey team immediately rather than wait for a formal declaration.

(3) Uniform guidelines should be prepared for survey officers which would provide for cross-checks with other agencies.

(4) When completed, the disaster survey should be sent to the Area Manager or RDC so that staffing, space, and other funding estimates can be based directly on the survey results.

C. LOAN SCREENING

Problem

The amounts and quality of disaster loans have been disparate due to inconsistencies in the interest rates and deficiencies in verification procedures.

Discussion

Due to economic pressures, there have been many changes in disaster interest rates and basic loan terms throughout the years. However, the limitations on home loans, personal property loss, and business loans have not been adjusted for the inflation rate.

Loss verification is a key aspect of SBA's physical disaster loan program. The Loss Verifier determines the amount of the loss after a visit to the affected home or business. Both the Agency and disaster victims will be forced to spend additional time adjusting projected losses to a more realistic amount if the Loss Verifier is not competent. Such incompetence may also facilitate abuse by supposed disaster victims; outright dishonesty by verifiers endangers the entire program.

Recommendations

(1) Establish one interest rate for homeowners, businesses, and non-profit organizations in physical disasters. Interest rates should not be changed when a large disaster strikes. Standardization of interest rates and loan terms should discourage false applications while remaining flexible enough to provide meaningful assistance to those who have suffered real injury.

(2) Raise the home loan limit on structural damage from $50,000 to $75,000, and the personal property loss limit from the current $10,000 to $15,000; for a maximum loan amount of $90,000.

(3) Raise the limitation on disaster business loans from the current $500,000 to $750,000.

(4) Set standards for hiring, training and evaluation of Loss Verifiers. The disaster cadre should include permanent verifiers who could provide guidance in surveys as well as in hiring and training of local verifiers. As with all disaster staff, the work of the verifiers should be reviewed periodically to ensure that verifications are adequate and comply with SBA regulations. Loss Verifiers who perform badly in one area must not be allowed to work elsewhere.

D. LOAN PROCESSING

Problem

Complicated application forms have resulted in confusion on the part of disaster victims.

Discussion

Disaster loan applications represent a myriad of forms, instructions, and examples which can intimidate even the most resolute potential applicant. The difficulties which applicants encounter in completing these forms have at times persuaded these applicants to seek out loan packagers who will perform this service for a fee.

The One-Stop Disaster Assistance Centers should be capable of providing disaster victims with the necessary assistance to complete the forms. Sufficient on-site advisors at the One-Stop Centers, available to answer disaster victims' questions, and simplification of the application forms, would greatly reduce the victims' perceived need for loan packagers.

Recommendations

(1) Simplify and standardize the loan applications on a coherent basis. Individual geographical areas may still choose to develop additional guidance or explanatory materials for use with the standardized forms.

(2) Establish a cadre of staff to be selected from the ranks of the SCORE volunteers for duty at One-Stop Centers. These individuals would be temporary employees on WAE status, available to report for duty within 48 to 72 hours of notice, and capable of remaining on duty for a general period of 2 to 4 weeks. (See also "Fraud, Waste and Abuse," III, H, 2, Loan Packagers, page 47.)

E. LOAN SERVICING AND COLLECTION

Problem

Inadequate collection procedures lead to large losses in disaster home loans.

Discussion

By the end of FY 1980, there were over 213,000 disaster home loans with an outstanding balance of $1,027 billion in the Agency's portfolio. Approximately 19 percent of the dollar volume, or nearly $200 million, is considered to be either past due, deferred, delinquent, or in liquidation. Inconsistencies in enforcement and collection procedures have allowed large amounts to be charged-off as uncollectible in certain areas of the country. SBA has had instances of borrowers repeatedly defaulting on disaster home loans.

Collateral to the inadequate collection procedures, is the decision as to whether the Agency should employ centralized or decentralized servicing policies with current SBA staffing resources. As of September 30, 1980, utilizing a centralized, computer-based service for which the existing central collection system provides, Regions I and III were found to have disaster home loans in other than current status by 23 percent and 19 percent respectively. Other Regions, using alternate methods of collection, were found to have from 11 percent to 27 percent of their disaster home loans in other than current status. For SBA to fully utilize a computer based collection, both a workable computer system and clear lines of responsibility vis-a-vis District Offices, would be required.

Discussions with several national finance companies and banks indicated that they have at times used central computer, telephone systems. However, these discussions also disclosed that although collection costs decreased significantly, trouble rates increased due to the lack of personal contact.

Other alternatives would include the use of collection agencies on a percentage of collection basis or the increase of in-house staffing to service the home loan portfolio.

Recommendations

(1) Continue the present central collection system with Regions I and III.

(2) Perfect the computer system to provide adequate support to those Regions involved, and as the system's capacity increases, add areas on a priority volume basis.

(3) Standardize policies for writing-off disaster home loans.

F. COMMUNICATION WITH THE PUBLIC

Problem

It has been difficult to disseminate accurate, timely information on disaster services.

Discussion

At present, many Regions are developing and distributing fact sheets which express a variety of interpretations of disaster regulations. In many instances, materials are not available in advance and valuable time is wasted preparing and printing them.

The recently formed cadre of disaster public information officers provides valuable professional information services, however, the reporting lines are not clear. Some Regions and Districts have encountered problems in their attempts to control the flow of disaster information.

Recommendations

(1) The ODO should develop and distribute updated fact sheets and booklets on disaster activities. This material should be suitable for distribution to staff, applicants, other disaster service organizations, banks, and community or trade associations.

(2) Generally, disaster public information staff should report to the Area or Regional Disaster Manager, with close liaison with Regional Public Information Officers.

(3) The Disaster Branch Manager or Acting Disaster Branch Manager should conduct congressional liaison activities. As direct managers they are better placed to respond to problems and advice raised by congressional staff and local government officials during disaster operations.

G. LIAISON WITH OTHER AGENCIES

Problem

The efficiency of SBA's coordination with other Federal agencies, principally Federal Emergency Management Agency (FEMA), varies in quality across the country. This variation at times hampers the smooth delivery of disaster services to victims and creates the impression of an inefficient Federal Government.

Discussion

In major disasters, a wide range of Federal and State benefits become available to individual victims. While these benefits are often mutually exclusive, many of them can be combined, making an assistance package of considerable complexity. In cases where all these benefits become available, there must be close coordination and exchange of information among agencies to preclude duplication and ensure the expeditious and efficient delivery of benefits to victims.

In Presidential disasters, the agency responsible for coordinating delivery of benefits is FEMA. While this discussion centers on FEMA liaison, there have been similar shortcomings in SBA's coordination with the Department of Agriculture in making disaster loans to farmers. This suggests that SBA has been responsible for at least some of the deficiencies in liaison with other agencies.

The Advisory Council has inquired nationwide into the success of SBA's coordination with FEMA. It appears that SBA disaster personnel have had good relations with FEMA in some Regions and poor relations in others. There is no uniform policy or procedure for this coordination between the two agencies.

Overall coordination has been made more difficult by the lack of internal consistency within each of the two agencies. FEMA has relied primarily on its coordinating role through the One-Stop Centers, in which all agencies involved are available to disaster victims. This has worked best when representatives of all agencies have been familiar not only with their own programs, but also conversant with basic objectives and features of other agencies' programs.

FEMA, however, has recently become involved in the actual delivery of services as well, through an experimental program called Combined Application and Verification Process (CAVP). The FEMA CAVP system failed in its recent test, therefore, the Council is recommending that until deficiencies in this system are corrected, SBA should decline to participate in any further tests. An unfortunate result of the failure of the CAVP system's test was that the responsiveness and efficiency of the entire Federal Government was called into question by the individual victims, local government and local press.

SBA has, in turn, created both internal and external problems through the variety of disaster delivery systems it has allowed. District Directors suddenly faced with organizing disaster services may never have heard of FEMA, much less have an appreciation for their role in disaster coordination. Generally, ongoing relationships with FEMA are handled on a Regional level within SBA, while actual delivery occurs on a District level. Thus, it is no surprise that SBA disaster employees, who are local managers, may be uncertain as to FEMA's role and responsibilities. This situation is made more difficult by the delivery methods both agencies have used.

Recommendations

(1) SBA should decline to participate in further CAVP tests until the serious deficiencies in this system are addressed to the satisfaction of all interested agencies. The Council has, however, recommended that some of the CAVP system's innovations be retained and others be discarded entirely.

(2) SBA should make a major effort with FEMA and other affected agencies to develop clear, effective guidelines for coordination during major disasters because disaster operations will always be staffed by a high percentage of temporary employees who cannot be given extensive training.

(3) SBA personnel, whether assigned full time or only intermittently to disaster work, should be thoroughly trained in disaster guidelines. Equally important, those same employees must be regularly examined and evaluated on their level of training and proficiency in disaster operations of all sizes.

H. FRAUD, WASTE AND ABUSE

1. Eligibility Claims

Problem

Disaster victims overstate losses to create greater eligibility for low interest SBA loans.

Discussion

We believe that false statements are made by applicants for two primary reasons:

(a) the SBA loan is made most attractive as a result of its low interest rates; and,

(b) the risks of detection and punishment have always been low.

Some applicants have been allowed to figuratively "write their own tickets" in declaring property loss due to an inadequate or untimely loss verification. In addition, past disaster legislation may well have encouraged false statements of loss by establishing the "forgiveness" policy, which amounted at times to an outright grant of $5,000. Later, second-time victims expected that a new loan would also be forgiven. Furthermore, inconsistency in forgiveness provisions would be resented by victims of disasters where no forgiveness was offered, making this a highly inappropriate disaster benefit.

Recommendations

(1) SBA should resist any legislative attempt to insert forgiveness provisions in future disaster lending legislation. Past experience with these provisions has been uniformly negative.

(2) Within the disaster cadre, SBA should maintain, train, and monitor enough Loss Verifiers (per our Recommendation at Section III, C, Loan Screening, page 34) to deter applicants from making inflated or false statements.

2. Loan Packagers

Problem

Some loan packagers obtain inordinately large fees from disaster victims who feel that they require assistance in the preparation of applications.

Discussion

Most disaster victims are homeowners with little business experience and less experience with the Federal Government. The spectre of wading through a complicated application process at a time of severe emotional distress may make the disaster victim an attractive target for the packager who, for a fee, offers help in completing and ostensibly expediting the loan application.

The current control mechanism on the use of packagers is for the loan applicant to disclose fees paid for assistance, at which time SBA reviews and either approves or denies the fees. Unfortunately, few SBA offices have developed schedules of reasonable fee levels to compare with those which are submitted. On the other hand, where SBA surveillance of packagers is strong, unscrupulous packagers have been known to persuade the borrower not to disclose the fee. In these cases, the packagers intimate or state that the fee will be shared with some SBA officials in order to expedite the loan.

Recommendations

(1) SBA disaster application forms should be simplified to reduce disaster victims' perceived need for outside assistance in completion.

(2) In disaster operations, SBA personnel should assist victims with applications, whether individually or in group sessions. This should include providing foreign language assistance where needed. (See also: Section III, D, Loan Processing, page 36.)

3. Misuse of Loan Proceeds

Problem

Disaster victims do not always use loan funds for the agreed purpose at the time of loan-making.

Discussion

Misuse of proceeds can, in the worst instance, increase the risk of the loan in that the property is never improved, thereby impairing SBA's collateral. In most cases, however, the major effect is that the borrower has the use of funds at a substantial savings over borrowing from another source. Besides the cost to the Government of the money that was lent, the end result is an inflationary increase in the amount of money in circulation.

Most of the control mechanisms to eradicate this abuse are prohibitively expensive, such as: re-verification, borrower certification of use of proceeds after expenditure, controlled disbursement of the proceeds, or a credible level of compliance auditing.

Recommendations

(1) On a pilot basis, SBA should use temporary personnel to re-verify the use of disaster loan proceeds on a random basis. The level of expense should then be carefully evaluated against its potential results. In order to maximize the credibility of the deterrent, loan officers should in all cases specifically notify the borrower that such a re-verification will take place. Recoveries under such an effort should well cover its cost.

4. Fraudulent Contractors

Problem

Disaster victims are often the target of unscrupulous or fraudulent contractors when attempting to effect home repairs.

Discussion

Too often in the past, disaster rates have attracted both local and other contractors who have taken advantage of the situation to provide sub-standard work at highly inflated costs. SBA has been hesitant or unable to provide fee schedules or referral services.

Recommendations

(1) As part of contingency planning for disasters, any assistance package which is developed should include information warning victims of contractor fraud schemes and protective measures which should be taken. This assistance package could also include a typical schedule of costs for the repair of common items.

(2) The training for disaster loan officers should include counseling to victims of the local sources of information about contractors, i.e., trade associations, Better Business Bureau, and prosecutors' offices. References to consumer referral services which are in liaison with local authorities and news media should also be included.

IV. PROGRAM ADMINISTRATION

A. PERSONNEL STAFFING: SOURCES, GRADES AND STAFFING PLANS

Problem

When a disaster occurs, we are often attempting to satisfy conflicting needs, and to satisfy them immediately. The problems included in fulfilling these needs are:

1. How to hire the right "mix" of positions prior to having adequate knowledge of expected workload;

2. How to attact and hold staff in temporary positions that may not be competitive in salary with what is otherwise available;

3. How to hire large numbers of technically skilled persons in remote areas; hire locally or bring them in on per diem;

4. How to use referrals successfully without falling prey to "cronyism;"

5. How to fulfill EEO requirements in hiring, even in areas with minimal minority population.

Discussion

Disaster Managers at present have no reliable guidelines to apply in staffing Disaster Offices with the right "mix" of professional, technical, and clerical personnel for the different types and sizes of disasters; nor do they have available guidelines to aid in making the decision as to whether to hire locally or bring personnel in from outside the area. Personnel in a disaster office have unique characteristics as to their qualifications, availability and compensation. All of these factors should be taken into consideration by the Disaster Manager and sources of recruitment of the required personnel identified in contingency planning well before disaster operations are begun of necessity.

The lack of reliable guidelines coupled with the unfamiliarity of some District Directors and other responsible officials with the variations and requirements of disaster operations combine on occasion to create inconsistent ratios, both in relative grade levels and numbers of employees, which frequently results in morale difficulties.

Finally, imposing EEO hiring goals when operations are to be conducted in geographic areas with little or no minority population is unreasonable. EEO goals should reflect the demographics of the affected disaster area and not be an arbitrary percentage which would incline managers to overlook local persons (when hiring them would lower per diem costs for the disaster operation) in favor of hiring distant members of minority groups.

Recommendations

(1) Development of guidelines for Disaster Managers to use in the determination of numbers, types, and grade levels required for various sizes and types of disasters.

(2) Sources of Employment:

(a) Managerial/Professional - The Disaster Cadre represents an excellent solution to the need for managerial and professional staff, however, the proposed cadre of 100 is far too small to produce the desired effects. In the last 5 years, SBA has employed at any given moment, a minimum of 920 disaster employees. Therefore, we recommend that the proposed cadre be expanded to 500 and that it be implemented immediately.

Alternative: Some local hire assistance can and should be acquired. A list of potential candidates can be obtained from local OPM offices and/or SBA District/Regional Offices. When one Region or area is unable to meet its requirements, however, it could call upon other areas or Regions to provide names of staff who would work during the disaster.

(b) Technical - Area or Regional Offices should keep lists of technical employees outlining their skills and availabilities.

Alternative: We must establish a vehicle for training local hires in technical positions. If SBA is able to train permanent staff in normal District operations as control clerks, administrative technicians or legal technicians in a relatively short period of time, it could also be done in disaster offices. This training would eliminate the necessity of paying per diem for technical staff.

Provision of such training for technical staff is a logical, effective use of cadre members. To encourage consistency, there should be clear and concise tools available, including programmed instruction kits. Many such tools already exist in the field and should be identified, perfected and used.

(c) Clerical - In recruiting qualified clerks, no avenue should be overlooked. The best sources for clerical help are State employment services, trade and technical schools, OPM offices, local SBA offices, newspaper advertisements, and public service announcements on radio and television. However, consideration should be given to the prevailing local wage structure. The grade offerings for clerical personnel are generally too low to employ the type of reliable and competent individual needed to do quality work under extreme pressure and with little supervision. In large, and even medium-sized cities, a GS-3 salary for a clerical person is simply not competitive, especially considering the temporary nature of the position, lack of job security, and the absence of fringe benefits.

Alternative:

(1) Extended use of word processing equipment would have the dual benefits of reducing the number of clerks required and raising the technial level (and therefore the grade -- level) of positions.

Standard home disaster loan documents are already available as "boilerplates" in at least one District Office (St. Louis). Any large Disaster Office being established should use or adapt these forms rather than go through the time and expense of recruiting, hiring, training, and employing an entire fleet of clerks to type each document anew. Certainly, area offices should encourage use of word processing systems in disaster offices.

(2) There are proposals for a limited per diem allowance (lodging only) for a few highly qualified and experienced clerks who show great promise and who might be trained for

higher level positions. Such limited per diem is allowable within the Federal Travel Regulations and SBA's SOP 20 11 1, Travel.

(3) "Cronyism" in hiring - "Cronyism" in hiring occurs on a number of levels and may at times be confused with an active referral system. (If the referred employee is poor, the general opinion would be that the employee had been referred as a result of "cronyism;" if the employee performs well, general opinion would be that the employee had been "referred.")

Experienced disaster staff frequently refer former colleagues for employment at new locations. However, the person making the referral may not be particularly familiar with nor concerned about the quality of performance of the people they refer.

Such forms of "cronyism" will only be eliminated when the cadre is in place and a logical organizational structure implemented. In this organizational structure, there should be a central staffing index, preferably computerized, which would catalog present and past disaster employees and their employment history. (See also "Performance Evaluation," page 65.)

(4) EEO Consideration - In areas with low minority representation, the typical response to EEO requirements in the past has been to "import" a few minority employees, pay them per diem, and then show good EEO figures. This did nothing to improve local minority employment opportunities, which in turn would have a favorable effect upon the local economy. The practice did, however, increase program delivery costs.

A more productive approach, which would create local employment opportunities for minorities, would include the following:

(a). Request that the EEO Officer go on-site to aid with minority recruitment, particularly in areas with low minority population or traditional under-representation of minorities in the work force;

(b) Perform on-going identification of prospective minority employees in disaster-prone areas.

B. OVERTIME

Problem

Overtime costs are a sore point in disaster planning and one of the first areas to be hit in cost reductions. Another school of thought holds that overtime may actually reduce overall costs if used judiciously.

Discussion

A standard criticism of Disaster Offices is that heavy overtime spending causes unreasonably high costs without a correspondingly high level of productivity. However, the following factors should be considered:

(1) Many professional staff are at a salary level which would require payment of only several dollars more per hour for overtime than their regular hourly rate.

(2) With subsistence costs as high as they are, overall costs can actually be reduced by approving overtime initially, thereby shortening the period during which staff would otherwise remain on subsistence.

Recommendations

(1) With the exception of the first several weeks of operation, no office should operate for more than 10 hours per day, 6 days per week; beyond this level, effectiveness is lost and costs outweigh benefits.

(2) One exception which may be made is to allow Loss Verifiers to work up to 12-hour days, 6 days per week. The nature of their work and the need to find people at odd hours makes this worthwhile.

(3) Easing the restrictions on the use of overtime makes it even more important to closely monitor the workload and to reduce the number of staff as the workload decreases. The cost savings which can be realized from permitting overtime is quickly lost without careful management.

C. PERFORMANCE EVALUATION

Problem

The lack of an adequate performance evaluation system has doomed us to repeat our mistakes by re-hiring unsuitable staff; similarly, we may be failing to reward good performers.

Discussion

There has never been a formal system for evaluating the performance of disaster employees. A need for standardized, objective performance evaluations maintained in such a way that hiring officials at disaster sites can evaluate applicants does exist. However, too often, incompetent or difficult employees are simply sent on to another office instead of being counseled, rehabilitated, or terminated. Despite its inadequacies, the current system is preferable to the pre-existing "blackball" system by which managers would arbitrarily proscribe a temporary employee from future disaster employment and other managers would comply. Usually, the reasons for this proscription were not told to the employee and not subject to challenge or correction.

Recommendations

(1) Develop a suitable performance evaluation method for disaster temporaries.

(2) Methodology for evaluation of disaster employees should be standard across the country. Included in this standard should be a requirement that disaster employees be evaluated at least once during each disaster operation in which they participate; and, that copies be maintained by the Area Manager or RDC.

D. PER DIEM

Problem

Per diem/subsistence allowances are inadequate in many parts of the country, creating hardships for many disaster employees. On the other hand, heavy per diem costs can cause total disaster operating costs to skyrocket.

Discussion

Many disaster sites are located in high rate subsistence areas, creating several problems for staff on temporary duty. First, it may be difficult to find suitable, convenient lodging within the amounts allowed. Second, staff spends inordinate amounts of time creating and completing vouchers which must detail every meal of every day.

On the other side of the coin, Managers are quite concerned about the high cost of running a disaster with a large number of staff who are on expenses.

Recommendations

(1) Increases in per diem and actual expense rates approved September 10, 1980, should relieve the cost burden on the employee. If fewer cities are designated as HRGA's (special high-cost areas), the detail required on per diem vouchers should be greatly reduced.

(2) The proposal above does nothing to allay managerial concerns about high costs. We feel that implementation of the disaster cadre is crucial to cost reduction. If full-time permanent disaster specialists are available to go into a disaster area, set-up opeations, and train local hires, it should do a great deal to reduce delivery costs associated with per diem.

E. BUDGET AND COST MANAGEMENT

Problem

Little, if any, substantive planning hs been done for disaster needs from year-to-year, either nationally or locally.

Discussion

At the national level, SBA annually encounters salary, expenses, and loan fund shortages. These shortages may range from a temporary inconvenience to a full-scale disruption, as in the last 2 years when the Agency was without disaster loan funds for several months.

At the local level, disaster work has always been a "reactive" task, with staff organizing in response to declarations. Too often the lack of monitoring and cost control has been excused due to the emergency nature of the work.

The underlying concept in our recommendations is that while individual disasters may come and go, SBA's disaster mission and relative level of activity continues. Therefore, we must begin to plan to meet this continuing level of demand, wherever it may occur. The development of area offices which report to one central location would greatly simplify the planning effort.

Recommendations

(1) Although we cannot predict actual disaster activity in any given year, it should be relatively simple to establish an average level of demand based upon non-farm disaster activity costs over the last 3 years. Such a base-line figure, adjusted for inflation, would be a starting point for annual requests both in loan funds and Salary and Expense funds.

(2) Area or Regional Disaster Managers should conduct surveys before a Branch Office is opened in order to develop realistic staffing and funding estimates. This projection should be reviewed monthly with estimates revised to reflect the actual level of activity. This method would provide a steady stream of information to ODO so that the ODO staff could monitor fund usage and better anticipate shortfalls.

(3) Similarly, ODO should monitor staffing requirements of Disaster Branch Offices, both in relation to guidelines on various sizes and types of disasters and in relation to other Branch Offices with similar responsibilities. Branch Offices with significantly higher staffing levels would be required to justify thoroughly and/or reduce staff.

(4) In addition to using historical data for planning purposes, we can also examine trends, both positive and negative. What patterns have been established in disaster Salary and Expense usage? Why do these patterns exist?

(5) Identification of cost-effective delivery systems should result in their application to as many disaster operations as is feasible. Points to examine include:

(a) A requirement for technical positions to be filled by local hires if cadre members are available to train them;

(b) A reduction in the number of clerical staff where the use of word processing equipment is warranted;

(c) A method of staff reduction as the workload declines. Again, Area or Regional Coordinators must be able to give solid justification for staffing levels;

(d) The purchase of equipment in disaster-prone areas to eliminate the need for costly long-term rentals.

F. PROCUREMENT OF OFFICE SPACE

Problem

The General Services Administration's (GSA) disaster space procurement methods are too often slow, inefficient, and insensitive. For its part, SBA's national space management staff have not advocated disaster needs properly to GSA at that level.

Discussion

While there are exceptions, our general experience is that GSA staff have been slow and difficult in handling disaster space needs.

For example, in one Region, GSA procured an enormous amount of space on a 1-year lease in an elementary school for the FEMA One-Stop Center. GSA had "assumed" that SBA would co-locate with FEMA and expected our loan processing office (which was open for 6 months) to be run out of a gymnasium with limited telephone service. When SBA protested, GSA claimed that all their lease allocation was tied up in the FEMA lease. The situation was later resolved, but SBA did not obtain adequate office space until nearly one month after the disaster was declared. GSA, in another Region, citing the President's requirement to locate disaster operations within the Central Business District, offered disaster space only within the downtown area when in actuality, the disaster occurred some 20 miles from the downtown area.

GSA claimed, in another Region, to require from 6 months to 1 year to obtain 7,000 square feet of space for a Presidentially declared disaster, as any requirement over 5,000 square feet required competitive bidding procedures. This situation was never resolved to the SBA's satisfaction and other space was obtained on a piecemeal basis.

Recommendations

(1) The best solution to the space problem would be to delegate acquisition authority to SBA for disaster needs, possibly limited to a specific dollar amount per square foot and/or a maximum term of 6 months to 1 year.

(2) If the above is adopted, authority should be re-delegated to the Area Manager. We must not eliminate the delays identified with GSA and replace them with delays from our own Central Office.

(3) An alternative would be to have GSA's Administrator issue specific guidelines on disaster space acquisition procedures to GSA Regional Offices. These guidelines should become part of the Federal Property Management Regulations. At a minimum, the procedures should include the following requirements:

(a) That space be procured immediately; for example, ready for occupancy within 10 days of receipt of requirements;

(b) That space be decent, usable office space suitable for relatively long term use. In other words, this is a need which is quite different from those of the initial One-Stop Centers.

(4) If there are now funding problems which create additional hurdles in the disaster space situation, SBA and GSA nationally should eliminate them. The yearly expense plan recommended in Section IV, E, would provide GSA with an estimate of our yearly disaster space requirements.

G. OTHER PROCUREMENT ISSUES

Problem

Many procurement regulations do not suit the immediacy of disaster needs. They range from being not helpful to being actually obstructive in the accomplishment of program goals. Within the disaster program itself, the inability or reluctance of program officials to plan ahead has forced us to beg for furniture or resort to costly rentals.

Discussion

None.

Recommendations

(1) SOP 00 11, Procurement, should specifically address the relative merits of leasing/purchasing disaster equipment, including a consideration of "stockpiles" of equipment and supplies across the country for disaster use.

(2) Any SOP published on word processing should include special recommendations for disaster needs. For example, considering the cost of word processing equipment rentals and training time required, how large/small does a disaster have to be to justify such rentals?

H. INTERACTION WITH OTHER SBA DEPARTMENTS

Problem

There is little connection between SBA's Disaster Offices and permanent offices, often leading to confusion and misunderstanding.

Dicussion

None.

Recommenations

(1) The Disaster Branch Manager should visit the local SBA District or Branch Office to inform staff of disaster activities and current disaster regulations. In addition, staff within the disaster office should be able to refer callers intelligently to the permanent office for assistance.

(2) Where disaster and permanent offices are located in the same city, the Disaster Branch Manager should attend weekly staff meetings and thus inform permanent office staff of Disaster Office activities.

Senator WEICKER. The next witness is Mr. Thomas Fahey, a certified public accountant of Alexandria, Va.

Mr. Fahey, raise your right hand. Do you swear to tell the truth, the whole truth, and nothing but the truth, so help you God?

Mr. FAHEY. I do.

Senator WEICKER. Be seated, identify yourself, and the committee will accept any opening statement you might have to make.

TESTIMONY OF THOMAS FAHEY, CERTIFIED PUBLIC ACCOUNTANT, ALEXANDRIA, VA.

Mr. FAHEY. My name is Tom Fahey. I am a certified public accountant. I was the audit manager for the company of R. H. Ritchey which conducted the 438 limited scope compliance audits of the SBA 7(b) disaster program. I have no prepared opening statement.

Senator WEICKER. Mr. Fahey, only that we might have continuity in our train of thought, I have some questions, but I think I will defer to Senator Dixon so he can pursue exactly what he was asking of the prior witness.

Senator DIXON. Thank you.

Mr. Fahey, you heard the question I just directed to Mr. Boucher. How often does the PCA come up in the audits you have made?

Mr. FAHEY. On the farm audits, the PCA came up just about in every case, not necessarily derogatorily, but the farmers were involved with PCA's in every case. PCA is not in every case some rich credit merchant preying on the farmer. Sometimes they are run on the excess capital of the local farm community, almost like a church credit union. That is not often the case, but it does happen.

What we observed with the PCA's were the complaints from the farmers that not only did the PCA's either recommend that the farmers go in and get the SBA disaster loan or that the farmers use the proceeds of the loan the way the PCA suggested, but the farmers also complained that the PCA's would make them borrow the money from the PCA for the amount of the SBA loan payment.

It worked as follows. When the SBA loan payments were to be repaid out of the $500,000 note, it might be a $16,000 annual payment. Farmers were set up with the SBA for annual repayments, usually in December. Maybe the farmer would estimate that $284,000 would be necessary to be borrowed to pay for fertilizer, seed, and labor to get the crop planted and harvested. The PCA would in turn tell the farmer to borrow an extra $16,000 on top of that, the amount of the SBA loan payment because they wanted to make sure that that loan payment was made because of the collateral position of the property.

In effect, the farmer was borrowing the $16,000 maybe as much as 9 or 12 months ahead of the time the payment was actually made.

Senator DIXON. I notice in those cases that have been brought up that PCA at least twice in those seven or eight has made recommendations that I find offensive, and perhaps illegal. It appears clearly to be illegal at least in one case. I wondered how frequently that occurred as a percentage of the whole group.

I get the impression that these PCA's come up almost all the time as credit advisers for farmers in these positions. Clearly in many of the cases we are seeing here, they are advising them to do things that are improprieties.

Mr. **Fahey**. That might be the case in these things. You are right. They are credit advisers to the farmers. In many cases, they are the farmers' entire financial management adviser from start to finish on that.

In most of the cases of the SBA disaster farm loans, the payments for the debt payments that were authorized were made to PCA's. They were the ones that by and large benefited the most of any single category from this program.

It would be difficult to stratify the loans by PCA's on this because the PCA problem turned up as a consequence of the misuse of proceeds or the double payments that we had. I think maybe the better slice of the pie would be to go back to the files and stratify the loans. First off, the ASCS made subsidized crop payments on roughly half a dozen crops. It would not take too much to go back to these loan files and see where any of these crops were used in evaluation of the loss. That would be your first cut.

As a second cut, you could look and see if the improper use of loan proceeds was usually the result or happened because the farmer had excess crop yield. In other words, he did not have the loss he had estimated. He had the excess capital and so he bought the certificate of deposit.

You could go back to the loan files and see which loans were made on loan estimates; in other words, estimated crop losses or grass losses as opposed to actual crop losses or grass losses.

I am talking now particularly in Atlanta. The way it started off was in August they knew they had lost their corn crop. They knew that to some certainty, but the pressure was on the SBA to put out the money. Therefore, they used estimated losses to value soybeans, pecans, and some of the other crops even though in the normal course of business the farmer might not have sold these crops had they come in.

Senator **Dixon**. May I pursue that a moment further, Mr. Chairman?

Senator **Weicker**. Certainly.

Senator **Dixon**. As a lawyer, I can understand how it is a difficult case to make when the fellow guesstimates a loss and then gets a windfall because the weather improves, for example, and the loss is not so great. While it bothers me that there are clearly abuses here, I do not see that as such an easy case to make. However, I see a number of cases here of duplicate applications for loans for the same purpose contemporaneous in time.

Mr. **Fahey**. True.

Senator **Dixon**. As a former practicing attorney who did some criminal work both as a prosecutor and on the other side of the table, the written sheet speaks the intention as far as I am concerned. How often does that occur? I see it occurring in these cases relatively frequently.

Mr. **Fahey**. Duplicate payments was a problem.

Senator **Dixon**. Yes; applications made by the same individual almost contemporaneous in time ought to be pretty clear-cut cases.

Mr. FAHEY. And well known to the SBA officials because they know which crops were paid on. That is the thing which surprised me in going through this. You knew that if a farmer had a corn crop, he got ASCS corn payment.

Senator DIXON. You see these duplications frequently?

Mr. FAHEY. Yes; we do.

Senator WEICKER. As the project manager for the SBA Inspector General contract audit on farm disaster loans, you coordinated and conducted extensive field audits of farm borrowers. Considering the audit findings, this appears to be only the tip of the iceberg. Based on your experience with the farm disaster program, do you agree that these audit findings only represent the tip of the iceberg? Do you believe that a full-scale audit of the entire program is warranted?

Mr. FAHEY. Yes; I do agree that it is the tip of the iceberg. Yes; I do agree that a full-scale audit is warranted. I disagree with Mr. Boucher's approach for two reasons.

First off, of primary importance and one of the reasons I wanted to pick this project out in these hearings is that you have to approach this problem with an attitude of fairness and consistency. The fairness has to apply to how much was the overpayment or duplicate payment. The fairness also has to apply to a standard that is applied consistently throughout the United States, not just in region IV or not just in a district where the district director is a go-get-them type and will get these payments back in but consistently throughout the United States.

Since these reports were turned in, I was gladdened to notice the serendipity of the collection of these payments with the concurrence of these hearings. I just hope that these collections can be followed through across the United States and not just concentrated in region IV.

I am worried about the concept that Mr. Boucher had of the auditors can go out and tell the program people. The program people made this mistake to begin with. The program people did not consistently apply either the law or the standard operating procedures that the SBA had throughout the United States.

I am not sure that approach would work. What I think may happen is you will have a farmer in Kansas with duplicate payments that may not be caught while the farmer in Georgia or South Carolina is paying back at least the duplicate payments or maybe even the 1.5 percent.

Senator WEICKER. Speaking for the Chair, I agree with what it is that you propose because it is not a region IV problem. I have no doubt that both in terms of the type and amount of abuse the percentage probably would apply across the board.

Maybe it is that there are more loans due to the disasters that took place in the Southeast coming out of region IV. That does not mean that the same type of abuse could not be taking place in some other region.

Mr. FAHEY. That is correct.

Senator WEICKER. I have no difficulty with what it is you propose. Indeed, I would only suggest since Mr. Boucher is in the room that the committee would expect that that standard of fairness be applied right across the board to all regions.

The purpose of the program is to assist the borrower. You have covered some of this, but let me just reemphasize that the purpose of the loans is to help the farmer recover from the disaster and to restore the farm to its predisaster condition.

However, it appears that in many cases, the borrowers were not only healed, but they ended up in a better position than they had before the disaster. Was this the situation you found? If so, could you give us an example?

Mr. **Fahey**. Yes. Looking at a farm as a business as opposed to a retail shop, first off, if you were a retail merchant caught in a flood and you got an SBA disaster loan, they would only give you the cost of your inventory. They would not give you market as the farmers did receive in the SBA disaster loan program.

Coupled with the SBA assistance at 3 percent money and the duplicate payments from the ASCS, the farmers did walk away with quite a bit more in some cases, not all cases. I agree with your opening statement that it is in no way indicative of something that is epidemic in the farm community. There are just a few farmers that did take advantage of a good thing. Maybe they were advised by the PCA's or maybe they saw it on their own. In some cases in Texas, there was a person who went around explaining to farmers what a good deal they were getting.

I do think that some of these farms were better off at the end of the crop year because the money that they received from the SBA may have been higher than the market value of the crops had they matured and sold had there been no disaster, and because of these duplicate payments from ASCS and FmHA.

The way the sequence seemed to start was the farmer came in with an estimated loss. In other words, he estimated a loss of $200,000 and only had a loss of $100,000. Because the formula was based on eligibility, he did get the $200,000 loan. He was $100,000 better off than he would have been had the disaster not been declared.

Senator **Weicker**. Senator Rudman?

Senator **Rudman**. Nothing, Mr. Chairman.

Senator **Weicker**. Senator Gorton?

Senator **Gorton**. No questions.

Senator **Weicker**. Another significant finding of your audit involves the business of duplicate loans. How did SBA allow these duplicate loans? How could they have prevented the abuse?

Mr. **Fahey**. Let me call them duplicate payments. In other words, SBA loaned money on crops that were already subsidized by the ASCS.

Two things happened. One was there was a breakdown in coordination with the local program people and either the county extension agent or the local ASCS office in a given county. They were the ones who were required to put the valuation on the amount of the crop loss.

Many times the county agents valued the crop loss without going out and actually investigating the fields and looking to see what was the actual loss on a particular farm. The SBA used this valuation of loss in making a loan.

In the meantime, at the office right down the street or sometimes colocated in the same building, the ASCS office, payments were being made to the farmer because of this low yield in corn or the other subsidized crops. Therefore, the farmer was better off in the end because he had these duplicate payments.

Some of the things we have recommended to the SBA was that the SBA approach farms as though they were a business. They did ask the farmer to tell them if they were going to get any ASCS payments or if they had any. At the time the applications were going in to the SBA, the payments had not in fact been made in region IV. As we went further west and the disasters were declared at different times, we found that problem to diminish. The farmers then received the SBA money and then some months later received ASCS money.

One of the reasons for the breakdown was that the SBA did not require the farmers to report a farm number. The ASCS offices in most cases had farmers tracked by farm number. My fear also is that if farmers are farming cross-county, in more than one county, we have not seen all the duplicate payments because the ASCS payments were made by county. The farmer might be in more than one county. Unless we could catch it on the farmers' books, we did not have a way of confirming with the ASCS how much money was paid out to a particular farmer without this farm number.

Senator **Weicker**. How did you find the coordination between SBA and the Department of Agriculture?

Mr. **Fahey**. We did not find much, if any, going on. The Department of Agriculture employees, either through the county extension agent or ASCS, submitted a loss estimate which the SBA took as gospel truth and then made the loan accordingly. In no case did we find where the SBA was going back out to the ASCS and in fact asking them how much was paid in ASCS payments on the subsidized crops even though I would expect it reasonable for the district personnel at the SBA to know that these payments were being made.

ASCS did not make these payments in petto. They advertised them quite heavily in the counties. It would have been a matter of reading the newspaper and just having to note this. Because of this breakdown is why we have this great deal of duplicate payments.

Senator **Weicker**. I have two last questions.

No. 1: We have come down on the head of the farmer. We have come down on the head of SBA. In your discussions with SBA officials and Agricuture officials, did you find any feeling on their part that they were being pressured by Senators and Congressmen to get these loans out?

Mr. **Fahey**. Yes, they did feel that they were being pressured.

Senator **Weicker**. Did that in any way contribute to a more cursory approach toward the granting of a loan than would normally be the case? Feel free to answer. I asked the question. I am ready for your answer. You may answer whatever your experience was. You talked to the people out there. I want to know the whole story.

Mr. **Fahey**. Mr. Chairman, what we noticed was a breakdown in internal control, probably because of the rapid placement of these loans. I cannot say that it was because of Presidential or congressional pressure. We just observed the breakdown. The breakdown does correlate in the States between where the most pressure took place from either Congress or the then President and the number of findings.

Senator **Weicker**. When the committee staff conducted its field investigation of the program, farmers and SBA officials told them that the farm borrowers do not feel compelled to repay these loans and that some farmers view the loans as grants that can be repaid informally. What kinds of attitudes did you discover in the field?

Mr. **Fahey**. I discovered that exact type of attitude. It was looked on that if it was a good year and they had the money, then they would repay the loan. There was also an attitude that the SBA had never foreclosed on a farm and thrown anybody out on the streets yet and they were not about to now.

Without any type of clout behind them, with the policy of just about automatically approving every extension or every deferment, every subordination that came into an SBA district office whether or not the SBA even checked the file to see whether the farmer was complying with the provisions of the loan authorization and loan agreement, with that type of atmosphere, I do think the farmers had that type of attitude.

Senator **Weicker**. After you got through with your formal work as an accountant, how did you feel as a taxpayer as far as your money was concerned?

Mr. **Fahey**. Two things: One is that this program was needed. The farmers were hurting at that time. I do not want us to focus on the farmers as the bad guys in this whole thing. There are a lot of factors bearing on this thing.

What amazed me was the lackadaisical attitude on the part of the SBA and the Department of Agriculture toward these programs and the fact that the money was just dispersed without what I would consider minimum documentation, let alone adequate documentation.

I am still concerned with the followup to these limited scope compliance audits and that people are not judging the responses from the districts in terms of sufficiency and adequacy. That bothers me. I think there is a lot of money out there that does not deserve to be out there. As a taxpayer, I do not like to see that.

I would like to see a vigorous program of not only getting the money back in but prosecuting or following up on the criminal and civil penalties that are available. I was amazed at the Department of Justice attitude of putting dollar amounts on cases or putting other factors on cases other than what seemed to be pretty good prima facie evidence of a possible wrongdoing.

One of the things I observed was the SBA threw in a lot of terms and conditions to the authorization and loan agreement. The one I like simply because I am in the profession is that the borrower was to submit audited financial statements annually. It is rather difficult, if not impossible, to audit a farm, but some farmers did attempt to comply with this provision because of their own personal integrity. Other farmers did not.

There are provisions for Federal flood insurance. There is a whole gamut of provisions—we call them boilerplate—that were placed in these things. A lot of farmers did strive to comply with this. Other farmers ignored it. The farmers who tried to comply with this boilerplate were incurring significant expenses.

I did not like the fact that one portion of the agricultural community was burdened with these excess expenses, in some cases several thousand dollars a year to comply, and others were just blatantly ignoring it. Yet both of them had their loans deferred and their collatoral subordinated as requested.

I think that is one place where we have to look if we ever hope to get the Government off the farmer's back. We need to look at a lot of these silly and not applicable provisions that were placed on the farmers.

Senator **WEICKER**. I am impressed with your testimony, Mr. Fahey.

Are there any further questions of Mr. Fahey?

[No response.]

Senator **WEICKER**. Thank you very much.

Mr. **FAHEY**. Thank you, Mr. Chairman.

Senator **WEICKER**. The next witness is Mr. John Keeney, the Deputy Assistant Attorney General, Criminal Division of the Department of Justice.

Mr. Keeney, raise your right hand. Do you swear to tell the truth, the whole truth, and nothing but the truth, so help you God?

Mr. **KEENEY**. I do.

Senator **WEICKER**. Identify yourself for the record and you may proceed with any testimony that you might have. Your prepared statement will be made a part of the record after your presentation.

TESTIMONY OF JOHN KEENEY, DEPUTY ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, DEPARTMENT OF JUSTICE, ACCOMPANIED BY JAMES GRAHAM, DEPUTY CHIEF, FRAUD SECTION, CRIMINAL DIVISION; AND HARRIET J. McFAUL, TRIAL ATTORNEY, FRAUD SECTION, CRIMINAL DIVISION

Mr. **KEENEY**. Mr. Chairman and members of the committee, I am accompanied by two of my colleagues from the criminal division: Harriet McFaul of our fraud section, and James Graham, deputy section chief in our fraud section.

I am pleased to appear before you today to discuss the problem of duplicate disaster loans to farmers by the Small Business Administration and by the Farmers Home Administration, an agency of the Department of Agriculture.

As you know, a computer matching effort was undertaken in the fall of 1979 by the SBA Office of Inspector General following a report from the Atlanta regional office that a farmer had received loans from both agencies for the same disaster loss. The purpose of the computer match was to determine the extent of duplication of benefits received by borrowers from SBA and FmHA.

Preliminary investigation by the USDA and SBA Inspectors General indicated the possibility of substantial fraud and abuse in the SBA and FmHA program in a number of States. Identifying some 119 potential duplications through the computer, the Inspectors General brought the matter to the fraud section of our criminal division which agreed to coordinate the investigation.

The fraud section participated in the selection by giving certain criteria which the Inspectors General should look for in selecting out cases and actually participated further in the selection of the cases which would receive full investigation by the SBA Inspector General.

The criteria initially used in the selection process included the dollar amount of the duplication, the number of possible duplications in one district, and the suggestion of criminal intent on the part of the farmer.

The 100 or so cases initially not selected for full investigation were held in abeyance pending investigation on the initial cases.

The 19 cases were thoroughly investigated. SBA and FmHA loan files of the selected borrowers were reviewed. SBA and FmHA officials were interviewed, as was each borrower. Verification of the use of SBA loan proceeds was made from the borrowers' records.

The results of the investigations were uniformly disappointing from a prosecutive standpoint. The SBA Inspector General brought 12 of the most promising of the 19 investigations to the assistant U.S. attorney having jurisdiction and to the criminal division. Prosecution of all of these cases was declined in favor of either pretrial diversion, a civil suit, or administrative action by the SBA.

The premise for initiating the investigation was that loan applicants knowingly sought duplicate reimbursements and deceived the SBA and FmHA in the process. The essential reason for criminal declination was the structure, management, and implementation of the particular disaster program.

Our review of the facts, however, disclosed that Government officials, in a few cases, were aware of the duplicative loan applications and encouraged loan applicants to accept duplicate checks. In some cases, SBA and FmHA loan persons could not be identified so that they could not be interviewed as to the procedures followed with respect to individual applications.

Different versions of the program and its regulations were propounded by various officials in both agencies. Additionally, program officials of Agriculture and SBA had limited communications with respect to this loan process. Similar problems in the implementation of the disaster loan program appear throughout the investigation reports.

Such problems make difficult, if not impossible, proof that a loan applicant knowingly made a false statement. Legitimate defenses of lack of knowledge, questionable materiality, and absence of criminal intent—all essential elements of the crime—are immediately suggested.

To be fair, Mr. Chairman, this situation must be put in perspective. The problems uncovered in the instant investigation are not peculiar to this program. To a certain extent, they appear in a substantial number of fraud against the Government investigations.

In the context of a disaster which requires speedy Government response, the use of temporary employees, and the inherent difficulties of the overlapping programs, prosecutive problems are exacerbated.

However, the value of this investigative effort is that it, in a small way, demonstrates the validity of several principles which we have learned during the course of our investigations and prosecutions involving a number of Government programs.

These are as follows: The design of the program is crucial to its effective organization. Coordination between two Federal agencies with overlapping programs is difficult and often unsuccessful unless emphasized by both agencies.

Regulations are at times vague and ambiguous, particularly here in the allowing of duplicative loans and not requiring certifications, thus contributing to fraud and abuse situations.

Criminal investigations and prosecutions for fraud against the Government are difficult where the program defrauded was administered in an inconsistent and uncoordinated fashion.

Finally, criminal prosecution is not the solution to program problems and is normally the remedy of last resort which should be utilized in conjunction with administrative actions and controls and civil actions.

Our review of the investigation suggests a number of program improvements which we believe have either been accomplished or are currently being examined by the SBA Inspector General: for example, clearer regulations, simpler agency management procedures, better control and training of loan officers, certifications of loan applicants, routine computer screens at the inception, better control on use of loan funds. These are important steps in assuring that the situation does not reoccur.

I have focused my testimony on some of the problems that we uncovered during our investigation of these duplicate disaster loans. It should be noted that there were many thousands of loans made, and I assume that the vast percentage were made correctly and in accordance with stated objectives of the program.

However, our review of these cases does indicate significant problems which our experience suggests are not peculiar to SBA or FmHA programs.

Mr. Chairman, that concludes my statement. I would be glad to respond to any questions that the committee may have.

Senator WEICKER. Mr. Keeney, this committee is blessed here by the presence of at least two former States attorneys general and one prosecutor. I am going to let these gentlemen bear the brunt of the questioning.

The only thing I want to point out here, because it was emphasized in my opening comments and by Mr. Fahey in his, is that the purpose of this committee's work is not to go ahead and indict the farm community but rather to find out where the difficulties lie.

I notice on page 3 of your statement you make the following statement:

> Our review of the facts, however, disclosed that Government officials in a few cases were aware of the duplicative loan applications, and encouraged loan applicants to accept duplicate checks.

Then at the bottom of that page of your statement, you say:

> To be fair, this situation must be put in perspective. The problems uncovered in the instant investigation are not peculiar to this program. To a certain extent they appear in a substantial number of fraud against the Government investigations.

I would suggest that as much of a concern to this committee as fraud against the Government is fraud by the Government as alluded to in your statement. I am going to let Senator Rudman take over for the initial questions. But make no mistake about it; if what you say is true as far as the encouragement of these fraudulent loan applications, believe me, I think that that is very definitely the business of your department. It certainly is the business of this committee, but it is the business of your department. I want to emphasize that point.

Let me say right now. If there is anybody in the scheme of things, be they politician or civil servant, we want to know about it. I think the boom ought to come down on their heads and not just those few in the farm community who are obviously misusing the program.

Mr. KEENEY. Senator, I did not mean to suggest that these people were deliberately knowingly aiding and abetting a fraud. What we were suggesting is that people were ill-trained. They did not know the program. They did not know their own regulations. They were giving bad advice to some of the farmers. If we found evidence of knowing fraudulent participation by Government employees, I assume we would have pursued it.

Senator WEICKER. Thank you very much, Mr. Keeney.

Senator Rudman?

Senator Rudman. Mr. Keeney, I am very troubled by the Justice Department's record or lack thereof in these cases. I have not had the advantage of looking over each of these files individually. I understand the kind of judgment that has to go in to deciding whether or not to indict, having been involved in literally thousands of cases involving this type of situation.

Of course the difference is that State governments normally pursue this kind of thing because State governments are closer to the people than the Federal Government and the people demand it.

I want to go through some of your testimony, but I get the distinct feeling that unless some of these U.S. attorneys out there do not get a nice slow ball pitched over the plate that they surely can hit out of the park, they are just not going to take on the case. That is not the way the criminal law is.

With that preamble, let me get into your statement. I want to pick up on page 3. I want to direct our attention to the standards that were used here. I will again refer to what our chairman referred to.

You say that some employees encouraged loan applicants to accept duplicate checks. Unless you mean by that statement that those Government officials, knowing of another application, induced these borrowers to accept a second funding, then it does not seem to me that that bears on prosecution.

Mr. KEENEY. I do not quite understand your question.

Senator RUDMAN. Let me put it this way. If I went out to buy a car today and one bank came to me and said, "We would like to loan you the money," and I said, "Fine, I will take it," and a second banker, completely unknown to the first, made the same offer to me, if I accept the second loan and give the same collateral, the fact that I have been approached by two has nothing to do whatsoever with my criminal intent. Right or wrong?

Mr. KEENEY. I agree with that; yes, sir.

Senator RUDMAN. Then the fact that loan applicants have been encouraged by anyone without knowledge is no defense.

Mr. KEENEY. Oh, I think it is, Senator, in this situation. You are coming in, you are applying for a loan, you are dealing with the people who administer the program, the people who are the experts. You say, "I have an FmHA loan of *x* amount and what else can I borrow?" They say you can borrow *x* amount and it will be legal because of their erroneous interpretation of the statute and regulations.

When we are talking about duplicate loans, Senator, there is a serious question as to what is meant here. To be illegal, a duplicate loan, in my judgment, has to be a loan from both agencies, loans from both agencies which exceed the actual loss.

If there were in fact duplicate loans and together they only equal the amount of the loss, that, in my judgment, at least for criminal purposes would not be taken into consideration. We would not prosecute.

Senator RUDMAN. I would agree that if the applicant told the particular agency employee——

Mr. KEENEY. That is what we have in a number of situations, sir.

Senator RUDMAN. If he told the particular agency employee that he did have another loan——

Mr. KEENEY. That is what I am talking about. They made the disclosure. Some of them made it in writing. Some of them made it orally. In some situations, there is a dispute as to whether they made it.

Senator RUDMAN. I have some cases I want to talk about, but we will agree with you on that. However, certainly you would agree with me that without that disclosure by the borrower, the fact that they are encouraged by agencies to accept money has nothing to do with fraud.

Mr. KEENEY. No. What we are basically dealing with, Senator, is a false statement to an agency of the Government of the United States, a material false statement or a material concealment. That is what we found lacking in these cases.

Senator RUDMAN. Let me talk about a case then because I only have a few moments here and I want to take one case.

I believe in this particular case the gentleman is one of our subpenaed witnesses this morning, the case of Mr. Thomas Earl Davis. I have an owner's affidavit in front of me. I will pass it out to you here if you want to look at it, but it is a standard affidavit. It affirms as to what the liens are on his various properties. It shows a first lien to a Federal land bank and a second lien to a PCA. It is in support of a substantial SBA loan which was in fact disbursed.

The date on this affidavit is January 5, 1978. Now on January 4, 1978, the day prior, this gentleman received a $321,000 FmHA loan and it was not disclosed. I want to pass this document over to you. My conclusion to you, sir, is that that on its face, in the absence of something I do not know, certainly is a material misrepresentation of a fact.

Mr. KEENEY. Senator Rudman, as a former attorney general, I am going to ask your indulgence. I feel very uncomfortable in discussing this particular situation when the witness is going to appear here and testify under oath. If you do not mind, Senator, at a later date I will submit with respect to this if you want, but I would ask to defer on this right now.

Senator RUDMAN. Fine.

Senator **Weicker**. I would suggest that the witness be given a chance to go ahead and testify. Then the matters that the Senator cares to go into can be gone into.

Mr. **Keeney**. I would be glad to do that.

Senator **Rudman**. Yes, I would like to do that.

I have looked at a number of these cases in which there are——

Mr. **Keeney**. I would be glad to talk about any of the others I am aware of, sir.

Senator **Rudman**. You have some others in your files, I am sure. What I would like to know is when there was not disclosure made, how can the Justice Department or various U.S. attorneys take the position of absence of criminal intent? I mean criminal intent can certainly be shown on application. There were applications in many of these cases.

Mr. **Keeney**. However, that is the problem. There were inconsistent applications. There were no certifications that there was not another loan made. There was not the specificity that is needed when you are, in effect, proceeding against somebody for false statement, which is in essence a perjurious claim to an agency of the United States.

Senator **Rudman**. Let me just wind up and ask you this, Mr. Keeney. When you assess probability of success as a basis for indictment, which most prosecutors do, what is your general standard? What are you looking for?

Mr. **Keeney**. More likely than not, more likely to be convicted than not. Those are the standards that are utilized by the department, sir.

Senator **Rudman**. Your review of these cases in which you had in fact applications which misrepresented material facts, even with those, your general feeling was that it was not more likely than not that you would be able to successfully prosecute?

Mr. **Keeney**. Except for two of them, Senator, that went into pretrial diversion, which, as you know, is where we take a case where it could be prosecuted and because we are dealing with a first offender and because of the other circumstances and the willingness of the individual to make restitution, which is usually a condition, we waive the statute of limitations and in essence he is put on probation for a period of time. If he does not meet the conditions of probation, he is prosecuted. Except for those, we did not find them sufficient, sir.

Senator **Rudman**. Mr. Keeney, I would suggest to you that those standards of course have to be interpreted by human beings and are very subjective. However, I believe that prosecution of these kinds of cases are very important because they serve as a significant deterrent to a particular community that commits a certain kind of fraud against the government, be it Federal or State. With all due respect to those standards, I have to disagree. I think some of them might have been prosecuted.

Mr. **Keeney**. Senator, I agree with you on principle. I just do not agree on the particular cases we have before us.

Senator **Rudman**. Thank you.

Senator **Weicker**. I think one of the difficulties that I find along with Senator Rudman is as a result of the testimony we have received today, there has been zero in the way of prosecution of these cases.

Mr. **Keeney**. That is right, Senator.

Senator **Weicker**. It is the zero figure that bothers me.

Mr. **Keeney**. If you consider pretrial diversion not prosecution, that is right. You are putting it in limbo to see if the person meets the conditions of probation. In those two, we did find the evidence sufficient to prosecute.

Senator **Weicker**. The difficulty is compounded by the fact that there are different standards and judgments, if you will, of our fellow citizens than the standards which you have to follow in formal pursuit of the justice process. However, if you ran these cases before the citizenry as a whole and asked to the citizenry to take a look at what has happened, and yet there has been zero in terms of prosecution, great incredulity would occur on the part of the citizenry as a whole.

Mr. **Keeney**. Senator, can we put it in perspective though? We are talking about zero out of 12. We had 12 serious referrals.

Senator **Weicker**. I suppose. We are talking about samplings, but everybody who has testified to date has indicated that what these samplings indicate is that there is a very broad based systematic abuse of the program.

Mr. **Keeney**. Abuse, but not provable fraud. That is the distinction, Senator.

Senator **Weicker**. I know. As I said, your standard has to be more precise. I have no quarrel with that.

Senator **Rudman**. I will say one thing, Mr. Chairman. I hope the standards are as precise as those we use when we prosecute people for stealing food stamps. I am speaking of users of food stamps. We take people who steal $150 of food stamps to feed their families and then we find these very sophisticated prosecutorial standards not to prosecute people who have defrauded this Government and these taxpayers of millions and millions of dollars. I think we ought to take a harder look at this, Mr. Keeney.

Mr. **Keeney**. Yes, sir.

Senator **Weicker**. Senator Dixon?

Senator **Dixon**. Let me first say, Mr. Keeney, that my entire impression of your testimony is that the most serious indictment is against the manner in which the program itself has been conducted in the past. Would you say that is a fair statement?

Mr. **Keeney**. That is a fair statement, Senator.

Senator **Dixon**. While I am troubled in the same way that my colleagues are here, I think the statement you have made is just replete with your view that the manner in which this program is conducted is such that it is difficult for the Government to make cases that to us seem to be fairly obvious cases. Is that a correct assessment?

Mr. **Keeney**. That is exactly correct, Senator.

Senator **Dixon**. As a person who has had experience as a prosecutor, as three of the four of us on this panel have had, these are the most common cases that you see in your office, the cases of someone who applies for two different loans on the same collateral. That is a run-of-the-mill case in every office in every State of the Union. It really concerns me that we see things here that look pretty obvious to us that obviously your in-depth investigation of the whole subject matter convinces you is the kind of case that has no jury appeal if you indict. Is that substantially what you are telling us here?

Mr. KEENEY. In most of them, Senator, I go beyond that. I say we do not have enough to get to a jury in most of these situations we are talking about because we cannot prove intent to defraud at all. In some of them, it is a close question.

Senator DIXON. With due respect to the judgment you have employed, Mr. Keeney, and I do not question it because each of us has to make our judgment in these cases, I do have to say that I have the same concern of my colleague about the kind of impression we are leaving in the country when out of all of these cases we cannot find a single one that we can make some kind of example of to discourage the continuation or proliferation of these kinds of cases in the future.

Mr. KEENEY. Senator, what we try to do in these situations is when we find difficulties with agency regulations and agency procedures, we try to bring it to the attention of the head of the agency. We have done this with SBA in working with Paul Boucher. We have done it recently with the Social Security Administrator. We have a very effective dialogue going on with him as to how to amend their regulations in a way that would make them better from a prosecutor's standpoint when there are violations.

We have done the same with HUD. We have done the same with HEW, now HHS. It is the type of thing we do when we find defects. The FBI does it now on a continuing basis as an emphasis on white collar fraud and abuse. When they wind up a case and it cannot be prosecuted and they see defects in the procedures which could be remedied, they bring those to the attention of the department and the relevant agencies.

Senator, we do not like this either.

Senator DIXON. I know you do not, Mr. Keeney. Let me pursue it one bit further. I heard you say something about certification. Were you trying to make the point that the form does not bear the proper type of certification at the bottom of it?

In other words, when a person makes an application for a loan in one agency and comes almost contemporaneously, such as the next day as in one case we are not going to pursue here, or a few days later, and makes another application, gets another loan, and does not reveal that prior loan on the second application—

Mr. KEENEY. What I had in mind with certification was something like you have on your insurance claims.

Senator DIXON. I understand what you are talking about.

Mr. KEENEY. That this claim is not being covered by another application or has not been covered by another loan.

Senator DIXON. The point I was trying to make, Mr. Keeney, was this: Are you saying that the Government form used does not bear the proper type of certification on the bottom of the form for the individual applicant to sign?

Mr. KEENEY. I was addressing it more not to that statement that is usually on the bottom of Government forms but a precise certification that the application being made herein was not duplicated in a previous application made by this individual.

Senator **Dixon**. I do not want to get argumentative here, Mr. Keeney, but I would have to respectfully suggest that if a person makes an application and lists the prior loans and does not list one to another agency, that on its face is a fraud that could make a case.

Mr. **Keeney**. It could be, Senator, if it is material and if it was deliberate.

Senator **Dixon**. In conclusion, the only thing I would ask of you is this: I would appreciate it very much if your department would review those cases that you find that do show a subsequent application for an additional Government loan with another agency that does not reveal a prior application for a granted loan from another agency. I would like you take another look at those. I think those are cases you can make.

Mr. **Keeney**. Prior application or prior loan?

Senator **Dixon**. Prior loan.

Mr. **Keeney**. We do have prior application situations. I do not think we have any prior loan situations.

Senator **Dixon**. You have no prior loan situations?

Mr. **Keeney**. No, sir, but we do have prior applications. There are a number of prior applications.

Senator **Dixon**. I thought we had cases right here.

Mr. **Keeney**. Senator, we will take a look at them again, but I think I am right. My colleague tells me I'am right.

Senator **Dixon**. I must say respectfully, Mr. Keeney, that it was my understanding that we had at least two or three out of the group that we were dealing with this morning.

Mr. **Keeney**. We will go back over them just to make certain.

Senator **Dixon**. I would appreciate that.

Mr. **Keeney**. However, I think that is not so.

Senator **Dixon**. Thank you, Mr. Chairman.

Senator **Weicker**. Senator Gorton?

Senator **Gorton**. I may have a somewhat different point of view than the questions which have been presented to you so far. I would like your comment on this.

It seems to me at least arguable that the frustration which is evident here in the committee where we are dealing with thousands of loans and hundreds of audits—there were originally 119 cases submitted for more careful scrutiny and 19 very carefully studied and no prosecutions—is not that the Department of Justice under two different adminstrations willfully ignored a law, but that we find ourselves in a situation where the prosecutorial discretion of the people in the field simply find it very, very difficult to get convictions before juries on the type of offense with which many jurors are likely to be reasonably sympathetic.

Is one of our problems in your view the fact that we may be treating as a crime in theory in our statutes here and elsewhere matters which as a practical matter just do not get prosecuted, period? Would you have a better chance as the Department of Justice if the kind of situations which were presented to us here today were civil offenses with a lesser burden of proof on the Government but with the sanctions, for example, of treble damages?

Mr. KEENEY. In a number of these situations, a civil sanction would be better, Senator, because there is a factual dispute in some of these as to whether they were advised by SBA people that they were entitled to it. For instance, they say that they wrote in to the SBA and there is no evidence of it. At least in one case we cannot identify the loan officer who processed it. That matter might possibly be appropriate for civil sanction, but it is a bit muddy for a beyond-a-reasonable-doubt standard.

Senator GORTON. Is it likely that there would have been a more aggressive attempt to bring litigation if the sanction were one which could be imposed on a preponderance of the evidence as opposed to the criminal burden of proof?

Mr. KEENEY. I do not know, Senator, because we have several of these matters that had been referred for civil collection. We considered that. I do not know whether or not if we had a stiffer civil sanction more of the cases would have gone through. I do not think very many would have.

Senator GORTON. However, under your present civil sanctions, all you are going to do if you win is just get the Government's money back.

Mr. KEENEY. The Government's money back, and there is a civil penalty section in there, too, that provides for what is described as a fine of 1½ times, but I do not think we referred any under that section.

Senator GORTON. In other words, that extra civil sanction is not one that you have used either.

Mr. KEENEY. That is right. We have not. We referred them to our civil division for them to make a determination, but we did not recommend any of them under that sanction. I believe that is correct.

Senator GORTON. Then do you have any suggestions for the Congress as to a way in which to rewrite statutes, not just this specific one but statutes of this sort, in such a fashion as either to make it somewhat easier to bring criminal prosecutions when there have been obvious abuses and misuses, or at least to bring a civil penalty action recovering more money, some kind of a penalty, which will get used?

Mr. KEENEY. Senator, we have in the legislative program a civil money penalties bill which might be helpful in this area. It is either in or being put in to the legislative hopper. It is part of the emphasis on the fraud and abuse in conjunction with the Inspectors General. I do not know whether it will address this problem.

I have problems with the evidence in these cases. That is my main problem. Whether we are talking civil, criminal, beyond a reasonable doubt or not, we have trouble proving these cases. My main point is that some of these cases could have been made as criminal cases if it were not for the administrative inadequacies.

Senator GORTON. That ends up leaving me with much of the same frustration Senator Dixon expressed with what is such an obvious misuse and we cannot find a single case from which we can recover either civilly or criminally.

Thank you, Mr. Chairman.

Mr. KEENEY. Senator, let me just finish. We can recover civilly in some of these and we are going to. We can also recover administratively. A number of these have gone back to SBA to start the process of trying to collect the loans where they are delinquent. In a number of the cases we are talking about, or at least a few of the cases we are talking about, the loans have been repaid.

Senator **WEICKER**. I have before me a letter dated September 11, 1980, addressed to——

Mr. **KEENEY**. Excuse me. I might offer for Senator Gorton that we have the utilization of civil remedies. I have it here on a sheet if I may present it into the record.

Senator **WEICKER**. Fine, it will be accepted.

[The material follows:]

CIVIL ADMINISTRATIVE REMEDIES

SBA IG reports that of the cases referred to Justice:

Two have been paid in full;

Two are making regular scheduled payments;

Four have been referred to Civil Divisions in U.S. Attorney's Offices; and

Four are being handled administratively (demand for payment made, arrangements in progress).

Senator **WEICKER**. I have before me a letter dated September 11, 1980, on the letterhead of the Department of Justice addressed to Mr. Marvin Shelton, Director of Financial Investigations, Small Business Administration:

DEAR MR. SHELTON: Enclosed please find the Department of Justice's recommended insert to your office's Consolidated Report on Investigations of Duplicate Benefits awarded under disaster programs of the Department of Agriculture and Small Business Administration.

I will submit the letter in its entirety for the record.

[The material follows:]

U.S. DEPARTMENT OF JUSTICE,
Washington, D.C., September 11, 1980.

Mr. MARVIN P. SHELTON,
Director of Financial Investigations, Office of Inspector General, Small Business Administration, Washington, D.C.

DEAR MR. SHELTON: Enclosed please find the Department of Justice's recommended insert to your office's Consolidated Report on Investigations of Duplicate Benefits Awarded under Disaster Programs of the Department of Agriculture and Small Business Administration.

I also enclose, per your request, a copy of the transmittal memo to the Federal Bureau of Investigation regarding the Commerce Capital Corporation matter.

Sincerely,

JO ANN HARRIS,
Chief, Fraud Section,
Criminal Division.
By HARRIET J. MCFAUL,
Attorney.

Enclosures.

INSERT AT END OF SUMMARY BEFORE RECOMMENDATION

A major factor considered by the Department of Justice in reviewing these cases was mismanagement and negligence by the SBA and FmHA loan officers. The Department of Justice was unable to recommend prosecution in several cases where criminal fraud was evident, because it considered that agency mismanagement had tainted the government's case.

Examples of agency mismanagement are numerous. In one case FmHA became aware of duplicate benefits one month after granting a $33,130 loan, neglected to report it, and subsequently granted the farmer three more loans. In another case, SBA granted a $74,600 loan in spite of the fact that the borrowers had failed to return an executed "certificate concerning only one Disaster Loan", the SBA file checklist clearly indicating non-receipt of the form after two requests that it be returned by the borrower to SBA.

In a third case, SBA made a duplicate disaster loan to a farmer who had fully disclosed prior receipt of FmHA loan for the same disaster. Duplicate Benefits amounted to $40,028. In yet another case, SBA duplicated $53,570 in disaster loan benefits, because of failure to verify the exact extent of the disaster loss. Investigation showed that the farmer himself was reluctant to accept the second loan and did so only after express approval from the regional supervisory loan officer and the Chief Disaster Attorney.

The Department of Justice suggested that firm agency guideline for its loan officers be adopted, including an interagency follow up procedure to prevent future duplication of benefits.

Senator **Weicker**. It is signed by Harriet McFaul. I believe she is with you today.

I wonder if you might read to the committee this particular insert. I will send a copy to you and ask that it be read. As I understand, this was sent from the Department of Justice to the Small Business Administration back in September of 1980.

Mr. **Keeney**. Insert at end of summary before "Recommendation." A major factor considered by the Department of Justice in reviewing these cases was mismanagement and negligence by the SBA and FmHA loan officers. The Department of Justice was unable to recommend prosecution in several cases where criminal fraud was evident because it considered that agency mismanagement had tainted the Government's case.

Examples of agency mismanagement are numerous. In one case, FMHA became aware of duplicate benefits one month after granting a $33,130 loan, neglected to report it, and subsequently granted a farmer three more loans. In another case, SBA granted a $74,600 loan in spite of the fact that the borrowers had failed to return an executed "certificate concerning only one Disaster Loan," the SBA file checklist clearly indicating nonreceipt of the form after two requests that it be returned by the borrower to SBA.

In a third case, SBA made a duplicate disaster loan to a farmer who had fully disclosed prior receipt of FMHA loan for the same disaster. Duplicate Benefits amounted to $40,028. In yet another case, SBA duplicated $53,570 in disaster loan benefits because of failure to verify the exact extent of the disaster loss. Investigation showed that the farmer himself was reluctant to accept the second loan and did so only after express approval from the regional supervisory loan officer and the Chief Disaster Attorney.

The Department of Justice suggested that firm agency guideline for its loan officers be adopted, including an interagency follow up procedure to prevent duplication of benefits.

Senator **Weicker**. When I initially asked you as to that portion of your statement relative to duplicative loan applications and encouraging loan applicants to accept checks, et cetera, you indicated at that time that you did not mean to impute any wrongful intent here and that this would have been unintentionally or innocent behavior, et cetera. This memorandum sort of belies that explanation of your statement.

Mr. **Keeney**. I view the memorandum as saying the chief disaster attorney made an incorrect interpretation. I know of no evidence that anybody acted wilfully to aid a farmer in defrauding the program.

Senator **Weicker**. Maybe we should ask Ms. McFaul what she meant.

Ms. McFaul, what did you mean by this statement?

Ms. **McFaul**. That the chief disaster attorney had said that it was all right.

Senator WEICKER. I am talking about right up there at the top. How do you read that?

Mr. KEENEY. Tainted the Government's case?

Senator WEICKER. That the Government's case was tainted. What does that mean? We certainly are not talking about any innocent behavior.

Mr. KEENEY. Tainted was probably not a good word to use because that does suggest that there was criminality and that the evidence could not be used because of some impropriety on the part of the Government investigator or official. I would restate it with Ms. McFaul's approval as saying rendered the cases unprosecutable.

Senator WEICKER. Are there any further questions?

[No response.]

Senator WEICKER. I have one more question. I might add, Mr. Keeney, that I have a series of questions that I would like to submit to you for response to the record.

Mr. KEENEY. I would be glad to answer them, sir.

[Subsequent information was received and follows:]

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C., October 15, 1981.

JOHN C. KEENEY,
Deputy Assistant to the Attorney General, Criminal Division, Department of Justice, Washington, D.C.

DEAR MR. KEENEY: On September 9, 1981, the Senate Committee on Small Business held a hearing on the Small Business Administration's Farm Disaster Loan Program. During your testimony at this hearing, I advised you that the Committee would submit to the Department of Justice a series of questions for the record. The questions follow:

1. On February 7, 1981, Philip Heymann, who was the Assistant Attorney General for the Criminal Division at the time, transmitted a letter to U.S. Attorneys across the country. The letter refers to the investigations of duplicate farm disaster loans, and states: "The Criminal Division considers these joint investigations to be of a high priority and are a major part of our strategy in dealing with fraud in Government programs." How often does the Department make criminal investigations, such as this one, a major nationwide priority?

2. Prior to February 7, 1980, what evidence did the Department have that would lead the Criminal Division to prioritize this particular investigation?

3. One case examined by the Criminal Division involved a farmer who received a $209,878 emergency loan from the FmHA and a duplicate $95,000 disaster loan from SBA. In addition, this farmer allegedly misused $26,889 of the SBA loan proceeds to purchase farm equipment plus cattle and seed for a separate operation even though the loan was authorized for debt repayment and crop planting. What were the Criminal Division's findings as to how SBA allowed this to occur, and why did the Department choose not to prosecute this case?

4. A second case examined by the Criminal Division involved a farm operation which received a loan of $83,410 from FmHA and a duplicate $122,300 loan from SBA. The operation borrowed funds from a bank to repay the duplicate FmHA loan, and then used SBA loan proceeds to repay the bank. In this case, what were the criminal Division's findings as to how the SBA allowed this to occur, and why did the Department choose not to prosecute?

5. A third case involved a farmer who received a $75,000 emergency loan from FmHA and a duplicate $37,300 disaster loan from SBA. How did SBA allow this to occur, and why did the Department choose not to prosecute this case?

6. Has the Department taken civil action against any borrower involved in the Criminal Division's examination of duplicate disaster loans? If the answer is yes, please detail action taken to date. If the response is no, please provide the Department's reason for inaction?

7. You testified before the Committee that the problems found in the Farm Disaster Loan Program investigations are "not peculiar" to SBA. Is this statement a condonation of the way SBA managed its Farm Disaster Loan Program? Does this statement mean that fraud in Federal programs is so widespread that the

Department of Justice is unable to correct these types of abuses? If not, please explain more fully what was meant by this statement.

8. During your testimony you requested that you be allowed to defer answering any questions concerning the case of Thomas Earll Davis because he was scheduled to appear as a witness before the Committee. As you know, Mr. Davis subsequently appeared pursuant to a congressional subpoena and testified under oath. Please provide the Committee with your detailed analysis and evaluation of whether the facts under which Mr. Davis obtained duplicate disaster loans from FmHA and SBA warrant either criminal or civil action by the Department of Justice. You will recall that, among other things, Mr. Davis not only failed to disclose the FmHA lien on an affidavit he executed for SBA on July 5, 1978—one day after executing the FmHA financing statement and deed to secure his FmHA debt—but also used his SBA loan proceeds for buying new farmland and refurbishing a home.

I would appreciate a prompt response to these questions. If there are any questions, please contact Mike Haynes or Marc Smolonsky of the Committee staff at 224-5175. Thank you for your attention to this matter.

Sincerely,

LOWELL WEICKER, Jr., *Chairman.*

U.S. Department of Justice
Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

NOV 25 1981

Honorable Lowell Weicker, Jr.
Chairman
Committee on Small Business
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This is in response to your October 15, 1981, letter to Deputy Assistant Attorney General John C. Keeney requesting answers to various questions your Committee had as a result of Mr. Keeney's testimony on September 9, 1981, regarding the Small Business Administration's (SBA's) Farm Loan Disaster Program. The following are the Department's responses to the eight questions posed in your October 15 letter:

1. The Department accords criminal investigations a nationwide priority on an infrequent basis. Important to our decision in connection with the instant investigations were preliminary indications that the problem was present in numerous jurisdictions, there was potentially a large amount of money involved and substantial use would be made of computers, which we encourage as a management as well as a fraud detection tool.

2. In late 1979, following a report from the SBA Atlanta Regional Office that a farmer had received duplicate loan benefits from SBA and the Farmers Home Administration (FmHA), a computer matching effort was undertaken to determine the extent of such duplication. Identifying some 119 potential duplications by name checks, the Inspectors General of SBA and the Department of Agriculture brought the matter to the attention of the Department of Justice. It was agreed that there was a possibility of fraud and that an investigation should be undertaken. To this end, certain cases were selected for full investigation by the SBA Inspector General, and the United States Attorneys in the appropriate districts were so notified by the February 7, 1980 letter referred to in question 1.

3. In the case referred to in question 3, a farmer obtained a $95,000 disaster loan from SBA and a $209,878 emergency loan from FmHA for the same loss. The farmer claimed that SBA was not concerned about this duplication and that an unidentified agency official, with knowledge of the FmHA loan, urged acceptance of the SBA loan for use as operating capital. While none of the SBA officials contacted would confirm or deny that such advice was given to the farmer, responsible officials did state that during this time period, there was confusion within the SBA regarding what farmers were entitled to in the way of disaster relief from SBA and FmHA. Indeed, SBA's former Chief Disaster Attorney suggested that there were few controls, no guidelines, and too many people making decisions. He further stated that he was not surprised that certain farmers had received duplicate loans. In the judgment of the Criminal Division, given the agency's admissions, proof beyond a reasonable doubt of criminal intent on the part of the farmer was difficult. For your information, the duplicate benefits involved in the instant case have been fully repaid.

4. In the case referred to in question 4, the farmer reportedly had disclosed the existence of an $82,410 FmHA disaster loan to an SBA loan officer who, nevertheless, approved an SBA loan which provided the farmer with duplicate benefits exceeding his loss eligibility by $82,410. When interviewed, the farmer stated that he had applied first to FmHA, then had heard that he could get more from SBA. The farmer reportedly asked the SBA loan officer if he could use an SBA loan to repay the FmHA loan. The SBA loan officer, after checking with an SBA attorney, approved the transaction. The farmer then borrowed $82,000 from a local bank and with these funds repaid the FmHA loan. He obtained an SBA loan, and used part of these proceeds to repay the bank. Such use of proceeds constitutes misuse according to SBA Standard Operating Procedures, misuse in which SBA participated. Indeed, the first SBA loan disbursement was made payable directly to the bank, a fact lending credence to the farmer's statements. It was the judgment of the Criminal Division that criminal intent on the part of the farmer was lacking.

5. In the case referred to in question 5, SBA made a disaster loan to a farmer after full disclosure by the farmer of his pre-existing FmHA disaster loan financing. The farmer had applied to SBA for a loan because the FmHA loan had not covered his actual loss. The farmer listed the FmHA loan several times in the loan application package which he gave to SBA. The SBA loan processor indicated awareness of the farmer's FmHA loan in his work papers detailing projected repayment. The FmHA loan was not mentioned, however, when SBA did the

calculation on the actual disaster loss. As a result, this farmer received $37,259 in excess benefits. Again, in the judgment of the Criminal Division, criminal intent to defraud on the part of the farmer was difficult to show. The matter was referred to the SBA District Director for administrative recovery.

6. It is our understanding that SBA has proceeded administratively against these borrowers for recovery where warranted. Where administrative recovery ultimately proves unsuccessful, SBA intends to refer the matters to the Civil Division for appropriate consideration. The matter of Thomas Earl Davis, which is currently being pursued by the Civil Division, is addressed in our response to question 8.

7. Far from "condoning" the way SBA managed its Farm Disaster Loan Program, the Department worked with the SBA Inspector General in drafting a report designed to call appropriate administrative attention to the program's deficiencies. While we recognize that the Department is in the business of reviewing matters for legal action on behalf of the United States, and not in the business of criticizing other agencies, we also felt we had a duty to point out to the agency those practices and procedures which, in our judgment, led to the difficulties encountered in proper program enforcement. Further, the Department welcomed the opportunity to express these same views to the Small Business Committee, feeling, that while we cannot solve the problem, proper administrative attention can.

The Department's remarks should not be construed as suggesting that "fraud" in Federal programs is so widespread that the Department is unable to "correct these types of abuses." To the contrary, it is not fraud that we encountered here, but agency mismanagement. Inadequate reporting systems and lack of staff training, as examples, apparently led to much of the difficulty in the loan program. These are not problems on which the Department is permitted to act. It should also be noted that nowhere in any of the reports was there a suggestion of fraudulent behavior on the part of SBA officials.

8. The matter of Thomas Earl Davis is presently being pursued by the Civil Division which is seriously considering initiating a civil proceeding.

I hope that we have satisfactorily answered any questions the Committee had as a result of Mr. Keeney's testimony. If I can be of any further assistance please do not hesitate to contact me.

Sincerely,

for Robert A. McConnell
Assistant Attorney General
Office of Legislative Affairs

Senator **Weicker**. I have here with me another memorandum dated January 13, 1981, from Alfred Morton, Assistant U.S. Attorney in Mississippi, to the SBA Assistant Inspector General regarding his review of several cases referred to the Justice Department for possible criminal prosecution.

Mr. Morton summarizes these cases by noting that: "The crux of the problem seems to be that these borrowers simply did not need the large sums made available to them at public expense. The disturbing thing is that this appears to be the case in six loans involving over $2 million out of seven reviewed in only one small Mississippi town. If this were found to be typical of the program across the country, the waste and abuse would be astronomical. Although no action can be taken in these cases, they do expose this gigantic loophole in the program and reveal the urgent need for thorough review and revision of the administrative controls to prevent such profiteering."

Mr. Keeney, would you consider this an accurate assessment of the problems which plagued the SBA disaster loan program?

Mr. **Keeney**. I noticed in a number of situations that the people who got the money apparently were not in a destitute situation. They had other resources. They have utilized the other resources to take care of some of the losses. The loans from SBA and FmHA merely made up for the resources that they used.

Senator, what we are talking about here is a program design problem and an implementation problem with respect to the regulations of the agencies. My understanding is that there is no requirement that there was a real crying need for assistance as an essential element of a loan application.

Senator **Weicker**. You are absolutely correct. The need aspect of the program is ill-defined if defined at all.

I have no further questions except those that will be handed to you for the record.

Thank you very much, Mr. Keeney.

Mr. **Keeney**. Thank you, Senator.

[The prepared statement of Mr. Keeney follows:]

Department of Justice

STATEMENT

OF

JOHN C. KEENEY
DEPUTY ASSISTANT ATTORNEY GENERAL
CRIMINAL DIVISION

BEFORE

THE

COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

CONCERNING

THE PROBLEM OF DUPLICATE DISASTER LOANS

ON

SEPTEMBER 9, 1981

Mr. Chairman and Members of the Committee:

I am pleased to appear before you today to discuss the problem of duplicate disaster loans to farmers by the Small Business Administration and by the Farmers Home Administration, FmHA, an agency of the Department of Agriculture.

As you know, a computer matching effort was undertaken in Fall, 1979, by the SBA Office of Inspector General following a report from the Atlanta Regional Office that a farmer had received loans from both agencies for the same disaster loss. The purpose of the computer match was to determine the extent of duplication of benefits received by borrowers from SBA and FmHA.

Preliminary investigation by the USDA and SBA Inspectors General indicated the possibility of substantial fraud and abuse in the SBA and FmHA program in a number of states. Identifying some 119 potential duplications through the computer, the Inspectors General brought the matter to the Fraud Section of our Criminal Division which agreed to coordinate the investigation.

The Fraud Section participated in the selection of nineteen of the 119 situations for full investigation by the SBA Inspector General. The criteria used in the selection process included the dollar amount of the duplication, the number of possible duplications in one district, and the suggestion of criminal intent on the part of the farmer.

The 100 or so cases initially not selected for full investigation were held in abeyance pending investigation of the initial cases.

The 19 cases were thoroughly investigated. SBA and FmHA loan files of the selected borrowers were reviewed; SBA and FmHA officials were interviewed, as was each borrower. Verification of the use of SBA loan proceeds was made from the borrowers' records. The results of the investigations were uniformly disappointing from a prosecutive standpoint. The SBA Inspector General brought 12 of the most promising of the 19 investigations to the Assistant United States Attorney having jurisdiction, and to the Criminal Division. Prosecution of all of these cases was declined in favor of administrative action as were the remaining less promising cases.

The premise for initiating the investigation was that loan applicants knowingly sought duplicate reimbursements and deceived the SBA and FmHA in the process. The essential reason for criminal declination was the structure, management, and implementation of the particular disaster program.

Our review of the facts, however, disclosed that government officials in a few cases were aware of the duplicative loan applications, and encouraged loan applicants to accept duplicate checks. In some cases SBA and FmHA loan persons could not be identified so that they could not be interviewed as to the procedures followed with individual applications. Different versions of the program and its regulations were propounded by various officials in both agencies. Additionally, program officials of Agriculture and SBA had limited communications. Similar problems in the implementation of the disaster loan program appear throughout the investigation reports.

Such problems make difficult, if not impossible, proof that a loan applicant knowingly made a false statement. Legitimate defenses of lack of knowledge, questionable materiality and absence of criminal intent--all essential elements of the crime--are immediately suggested.

To be fair, this situation must be put in perspective. The problems uncovered in the instant investigation are not peculiar to this program. To a certain extent they appear in a substantial number of fraud against the government investigations.

In the context of a disaster which requires speedy government response, the use of temporary employees, and the inherent difficulties of the overlapping programs, prosecutive problems are exacerbated.

However, the value of this investigative effort is that it in a small way demonstrates the validity of several principles which we have learned during the course of our investigations and prosecutions involving a number of government programs.

-- the design of the program is crucial to its effective organization;

-- coordination between two federal agencies with overlapping programs is difficult and often unsuccessful, unless emphasized by both agencies;

-- regulations are at times vague and ambiguous, particularly here, in allowing duplicate loans and not requiring certifications thus contributing to fraud and abuse situations;

-- criminal investigations and prosecutions for fraud against the government are difficult where the program defrauded was administered in an inconsistent and uncoordinated fashion;

-- criminal prosecution is not the solution to program problems and is normally the remedy of last resort which should be utilized in conjunction with administrative actions and controls and civil action.

Our review of the investigation suggests a number of program improvements which we believe have either been accomplished or are currently being examined by the SBA Inspector General, for example, clearer regulations, simpler agency management procedures, better training and control of loan officers, certifications of loan applicants, routine computer screens, better control on use of loan funds, etc. These are important steps in assuring that the situation does not reoccur.

I have focused my testimony on some of the problems that we uncovered during our investigation of these duplicate disaster loans. It should be noted that there were many thousands of loans made, and I assume that the vast percentage were made correctly, in accordance with stated objectives of the program. Our review of these cases, however, does indicate significant problems which our experience suggests are not peculiar to SBA or FmHA programs.

This concludes my statement, Mr. Chairman. I shall be pleased to respond to any questions you or the members of the committee may wish to ask.

INTENTIONAL BLANK

Senator WEICKER. The next witness is Mr. R. V. Segars.

Mr. Segars, raise your right hand. Do you swear to tell the truth, the whole truth, and nothing but the truth, so help you God?

Mr. SEGARS. I do.

Senator WEICKER. Mr. Segars, would you identify yourself for the record?

TESTIMONY OF RAY V. SEGARS, JR., OSWEGO, S.C.

Mr. SEGARS. My name is Ray Segars, Jr., Oswego, S.C.

Senator WEICKER. Mr. Segars, under the rules of procedure of the Senate Committee on Small Business, your attorney may be present during your testimony. You have the right to consult him before answering any questions. Do you have any attorney with you today?

Mr. SEGARS. No, sir.

Senator WEICKER. You should also understand that you have the right to consult with your attorney after we ask any question, or you can consult with your attorney at any time under the rules of the committee. Do you understand that right?

Mr. SEGARS. Yes, sir.

Senator WEICKER. As I have indicated, in addition to your rights as a witness, you also have an obligation while testifying before this committee. You have sworn to testify truthfully. If you do so testify, you are obligated to provide truthful answers so as not to subject yourself to the laws and penalties regarding perjury. In addition, in the event you do decide to testify, anything you say can be used against you in any other proceeding.

Mr. Segars, do you understand your rights and your obligations as a witness before this committee?

Mr. SEGARS. I do.

Senator WEICKER. First of all, let me thank you, Mr. Segars, at the outset for appearing here today. I appreciate the seriousness of economic problems plaguing farmers such as yourself in the country. I am particularly aware of the hardships that you and other farmers have suffered as a result of a series of devastating drought disasters.

You have had the opportunity today to hear testimony of the SBA Inspector General concerning his office's findings relating to the SBA loans received for your farm drought losses. No one is arguing with the legitimate needs of farmers for disaster assistance.

You have also had an opportunity to hear both the testimony of the accountant who did the audit on behalf of the SBA and of the Department of Justice. You have also had the opportunity to hear the comments of this committee. What we are trying to do is ascertain exactly what the needs of this program are while at the same time assuring that the program's efforts go to those who truly need them. This in no way is an indictment of the farm community or indeed any individual within that community.

Before proceeding to any specific questions about some of the allegations relative to the loan made to you, some of which allegations are rather serious, I would like to give you the opportunity to respond to anything you have heard and the opportunity to make any statement that you wish.

Mr. **Segars**. May I make a short statement?

Senator **Weicker**. Go right ahead.

Mr. **Segars**. First, let me say that as a member of the agricultural community, I appreciate the comments you made on the committee's behalf as to how you feel toward the farmers and the state of the economy of the farm community.

I have been asked to testify on the SBA's farm disaster loan program. I thank you for this opportunity to appear before your committee.

I would like to say just a little bit about my training and experience as a farmer. I am a third-generation farmer from South Carolina with a degree in Agricultural Engineering from Clemson University in South Carolina. I farmed with my father for 22 years and have been on my own for the past 10 years since my father's retirement.

I am still planting the same lands that have been farmed since the very late 1800's with the same crops: cotton, corn, and wheat. In the 1940's, we began to grow peanuts and soybeans. Those are the five crops that we now grow.

I feel this diversification of crops gives us a better chance that we not suffer a total crop disaster on our entire acreage. This has been true for my entire farming career of 32 years with the exception of 1977 and 1980, which turned out to be total disasters for all crops due to drought and heat.

I would not be here today as a representative of the farm community had it not been for the SBA farm disaster loan program. It has been a good program and worthy of praise as pertaining to the loans that were made to the farmers in the Southeast after the 1977 crop year.

The disaster loans were made as expeditiously as possible and with an attitude of trying to be as helpful to the farmers in our plight as rules and regulations would permit. I emphasize the word loan. This has not been and is not a giveaway program. I do not know of a single farmer who would want it to be. This is a loan program to help the American farmers continue their work as the most efficient production team in the world.

If we farmers are to continue on, we must be assured of fair prices for our crops so that we can make profits during years that we have good yields and be able to pay back debts and build back capital.

Gentlemen, there are serious economic problems facing farmers today. These problems cannot be solved by the farmers alone. When a yield of 100 bushels of corn per acre does not make a profit, there is something badly wrong with the system.

I noted in the paper this morning that the cash price yesterday of corn was $2.77, which compares with $3.475 of a year ago. That is a 70.5-cent-per-bushel reduction. Soybeans were $6.365 yesterday and $7.94 a year ago. These figures came from the Wall Street Journal of this morning. That is down $1.575 a bushel. Cotton was 90.60 a year ago and yesterday was 60.40. That is down 30 cents a pound or one-third.

I realize that last year was a drought year and prices may have been higher in some instances—certainly in the case of cotton—

than they should have been due to the drought situation. However, they should not be as low as they are now.

The American farmer is being penalized for good production. I beg you to study closely the effects of a free market theory as applied to farm production on the American economy. Also, please make every effort to keep open and expand our markets abroad.

In closing, let me assure you that American farmers are not a special interest group looking for special favors. American farmers are a special group of Americans working for America.

I would be glad to answer any questions, sir.

Senator WEICKER. Mr. Segars, on December 29, 1977, you applied for an SBA disaster loan. On March 11, 1978, SBA authorized your loan which provided specifically that one-half of your loan could be used for debt repayment and the second half for crop replacement. On April 11, 1978, you received a $485,900 disaster loan from SBA to cover your losses due to a drought. Is that correct?

Mr. SEGARS. Yes, sir.

Senator WEICKER. On December 29, 1977, you signed an attachment to the SBA loan application that you did not expect to receive from any other source financial aid to compensate for loss or injury sustained by crop loss due to the drought situation. You also agreed to notify SBA if you received funds from any other source, Government or private, which could be considered reimbursement for losses suffered due to the disaster.

Yet you received a grant from the Agricultural Stabilization and Conservation Service of $39,063 for the drought disaster. You did not notify SBA of this payment. Nor did you repay that amount to SBA when the agency demanded payment on October 31, 1980.

The obvious question is why not, and how does the loan from the ASCS connect with the statement you made in your application for the loan?

Mr. SEGARS. We have not been under the financial economic conditions to make those payments. I have no problem with repaying the full amount of the loan, but there has just been no way since that occurred that we could make that payment back.

Senator WEICKER. However, in the course of signing your application back in December—I have a copy of it right here before me—it says: "I do not expect to receive from any other source any financial aid by way of grant, loan, insurance recovery, or otherwise to compensate for loss or injuries sustained by crop loss or other causes as a result of the existing drought situation."

It has a heading called source of additional aid, and you have written in "None." Then you signed it. That is contrary to what happened, is it not?

Mr. SEGARS. Well, as I recall in our records, some of that total sum that is referred to was received prior to that time. I believe one amount of it was received prior to that date. The date that the statement you are referring to was signed, as I recall, I did not know what it would be. I did not know what would be received later on. It was received much later on.

Senator WEICKER. Either way, counsel informs me that if you received it prior, you should have notified SBA, and if you received subsequently, you should have notified SBA. The SBA was not notified in either instance.

Mr. SEGARS. I am not——

Senator WEICKER. In any event, the demand was made upon you by SBA to go ahead and repay the amount and you said you were not going to repay it. Why not?

Mr. SEGARS. I did not say that, sir. I did not intend to say that if I did.

Senator WEICKER. You have not repaid that amount.

Mr. SEGARS. I have not paid it, no, sir. I have not been financially able to pay it.

Senator WEICKER. Again, Mr. Segars, your loan authorization stipulated that you must use the loan proceeds for debt repayment and crop replacement. On March 11, 1978, you signed a receipt for and certification of use of proceeds in which you listed the use of loan proceeds. You agreed to use the funds for rent, chemicals, fertilizer, labor, repairs, fuel, insurance, and seed.

However, the SBA Inspector General audit found that you placed $55,117 of loan proceeds in commodity futures. Why did you place the loan proceeds into an unauthorized investment? Why did you not repay this allegedly misused money when SBA demanded by letter of October 31, 1980?

Mr. SEGARS. We use hedging in our business. We are also in the business of the purchase of grains. We use the business of hedging in this. That is not one lump sum payment there. Those are multiple payments. I am sure the total is correct, but it was a multiple of payments that we use in our hedging operations.

We can substantiate that and substantiate continuing on with our business where those moneys would come back into our business for the purpose and use of the production of our crops.

Senator WEICKER. Again, I have before me a SBA document signed by you on April 11, 1978:

> For the purpose of inducing the Small Business Administration directly or through the (blank), participating lender, to disburse the above loan or to guarantee the participating lender to disburse the above loan or to guarantee its percentage thereof, the undersigned borrower does hereby certify the proceeds of this disbursement on the account of this loan will be used or has been used for the new crops as set forth below.

There in your own handwriting is: rent, March-April, $40,260; chemicals, March-April, $115,000; fertilizer, February-March-April, $76,000; labor, January-April, $43,373; repairs, January-April, $20,200; fuel, January-April, $32,530; insurance, January-April, $9,485; seed, March-April, $37,650, for a grant total in your handwriting of $374,498. I do not see hedging. There is no category in which you wrote down hedging or commodities futures, nothing like that at all.

This is your statement that you made. I only want to contrast that with what you did. What category does hedging come under? Does that fall under fertilizer or what?

Mr. SEGARS. No, sir, it would not fall under any of the categories that you have listed.

Senator WEICKER. Then how does that expenditure relate to what you certified?

Mr. SEGARS. We only have one bank account for the total business operation. That is just a technicality and construed as the usage of the funds for that purpose, but the funds were used in all those categories also.

Senator Weicker. Counsel points out to me that the first check for your commodities purchase came within 2 days after signing this document of how you were going to use the money.

Mr. Segars. Well, that is just coincidental, sir. I do not know. I am sure it proceeded over a period of time beyond that, too.

Senator Weicker. Yes, it did. Have you paid the moneys back as requested by the SBA?

Mr. Segars. No, sir. However, those funds came back into our business, into the company, for the purpose of making a crop later on. I can verify that.

Senator Weicker. I do not believe that to be an argument, Mr. Segars, because if Congress intended these disaster loan moneys to be used for speculations which could potentially realize profits, or draw a loss, we would have said so. It is not included in what this money is permitted to be used for.

Mr. Segars. Sir, hedging is to——

Senator Weicker. That is your problem. That is not the problem of the taxpayer. That is the point I am trying to make.

You are signing your name to statements as to what you are going to use the money for. That is what the people of this country are giving you the money for. There is nothing in here about hedging. There is nothing in here about commodities futures. Then when the time comes to pay back the money so it can be utilized for those farmers which need the things you have listed here and which the Congress intended they get, the money is not there.

The loan authorization required you to notify SBA if your actual crop yield on your damaged crops exceeded the estimated yields you provided to SBA. The SBA Inspector General audit found that you received an excess crop payment of $73,829. You did not report this excess crop yield to SBA as required. Do you agree with the audit findings, and, if so, why did you not report the excess crop yield to SBA as you agreed to when you were granted your loan?

Mr. Segars. I am not in agreement with that figure, sir.

Senator Weicker. In response to the question, you are indicating that you did not receive an excess crop payment?

Mr. Segars. No, sir, I am not saying that we did not, but I am questioning the figure. I have never really had that. Until today, I never saw the breakdown of what the auditor used for the various figures.

Senator Weicker. As I understand it, you were notified again on October 31, 1980, by the SBA district office in Columbia, S.C. that you had to pay the excess funds.

Mr. Segars. Yes, sir, but it was total figure.

Senator Weicker. That was October 31 of 1980. Here we are in September of 1981. What has happened in the intervening year? It has been 1 year since you were notified. You are telling me that this is the first time now that you are questioning this?

Mr. Segars. I guess so. I was not able to pay it.

Senator Weicker. Senator Nunn?

Senator Nunn. I just came in. I will have some questions later.

Senator Weicker. Senator Dixon?

Senator Dixon. Mr. Segars, let me ask you a series of questions so that I can see whether you and I understand one another.

You went into the SBA and you asked for a loan of $485,900 to pay for your disaster due to drought in 1977. Is that true?

Mr. SEGARS. Well, you went in and you gave them your acreages. As I recall, the figure was computed by them as to what you were entitled to borrow. I did not go in myself and ask for that specific figure, no, sir, but it was computed by some method to determine up to what amount we would be entitled to borrow.

Senator DIXON. It involved corn, soy beans, and cotton in 1977?

Mr. SEGARS. Yes, sir.

Senator DIXON. The total amount that they gave you predicated upon your loss there was $485,900. Is that not true?

Mr. SEGARS. Yes, sir.

Senator DIXON. That is true?

Mr. SEGARS. Yes, sir.

Senator DIXON. You got that money?

Mr. SEGARS. Yes, sir.

Senator DIXON. In addition to that and before you got the $485,900, you received $39,063.81 from the Agricultural Stabilization and Conservation Service, did you not?

Mr. SEGARS. Yes, sir.

Senator DIXON. You got that?

Mr. SEGARS. Yes, sir.

Senator DIXON. You got that before you got the $485,900?

Mr. SEGARS. Yes, sir.

Senator DIXON. They were both for the same disaster, were they not, Mr. Segars?

Mr. SEGARS. Yes.

Senator DIXON. The 1977 crop?

Mr. SEGARS. The 1977 crop, yes.

Senator DIXON. Affecting those three commodities I talked about, right?

Mr. SEGARS. Yes.

Senator DIXON. You dealt with a Mr. Greenley. Is that right?

Mr. SEGARS. No, sir.

Senator DIXON. You do not know who Mr. Greenley is?

Mr. SEGARS. Yes, I know who he is. I dealt with him later on but not in the process of making the loan.

Senator DIXON. Not in the process of getting this money?

Mr. SEGARS. No, sir.

Senator DIXON. Why did you not tell the SBA when you got this $485,900 about the fact that you had received on a previous occasion $39,063.81? Why did you not tell them that?

Mr. SEGARS. I guess I just did not realize I was supposed to at the time, sir, even though the chairman has stated that I signed a certification, but a lot of time has passed and a lot of problems occurred during that period of time. There was no intent on my part, sir. These figures are correct.

Senator DIXON. This $485,900 was for your whole loss.

Mr. SEGARS. Well, that was what we were entitled to under the formula.

Senator DIXON. Yes; that was for your loss, but you also got $39,000 extra for your loss that you did not tell them about. Is that not true?

Mr. SEGARS. It appears that way, but truly it was not my intent that way.

Senator DIXON. The question of your intent is for others to resolve. We are not trying to resolve it here. I just want to get at the facts. You knew the $485,000 was for your whole loss in 1977. You knew that, did you not?

Mr. SEGARS. Yes, sir.

Senator DIXON. Sure. You also knew you got $39,000 in addition.

Mr. SEGARS. Yes.

Senator DIXON. However, you did not tell SBA about that.

Mr. SEGARS. No.

Senator DIXON. Now in addition to that, Mr. Segars, when it was all figured out, you really only lost $412,042 that year. Is that not true?

Mr. SEGARS. I am not going to be held to that figure because I am not sure if that figure is correct or not.

Senator DIXON. If the record showed that that figure was correct in the audit made by the appropriate and proper authorities, you would agree with that figure, would you not?

Mr. SEGARS. Sir, as I stated earlier in talking about the other businesses that we are involved in as a part of our total business operation, it is entirely possible that some of the crops purchased from other people in the elevator business have gotten into some of these figures. That is why I am not certain of that figure being correct.

Senator DIXON. Let me show you, Mr. Segars, what we are concerned about here at this table and what the Government is concerned about. In 1977, you received in total $112,921.81 more than you actually even lost.

Mr. SEGARS. That is the figure I am talking about, sir.

Senator DIXON. Yes, that is the figure I am talking about, too, Mr. Segars, that we are concerned about. Do you see why that troubles us?

Mr. SEGARS. I can see why it would.

Senator DIXON. Who did you talk with there?

Mr. SEGARS. I do not know the auditor's name. Where are you talking about?

Senator DIXON. The person you talked to who gave you the money. Who was that person? Do you know his name?

Mr. SEGARS. No, sir.

Senator DIXON. However, you do know Mr. Greenley?

Mr. SEGARS. Yes, sir.

Senator DIXON. Who is Mr. Greenley? He comes up in this report a lot. Who is he?

Mr. SEGARS. Apparently he was the administrator of this program. He was the man I talked to at times when I was delinquent in being able to pay back.

Senator DIXON. What was his first name?

Mr. SEGARS. I do not know, sir.

Senator DIXON. What town is he in?

Mr. SEGARS. He is in Columbia.

Senator DIXON. He is with the SBA?

Mr. SEGARS. Yes.

Senator DIXON. Did he ever tell you that you could have this additional money or that it was all right?

Mr. SEGARS. No, sir. I had not discusssed this with him.

Senator DIXON. Nothing further.

Senator WEICKER. Two points, Mr. Segars: On the loan authorization that you received—I am sure you read it because it is giving you $485,900—on page 2 it says: "Borrower agrees—this is the condition—"to notify SBA of any funds received from any source, Government or private, which could be construed as reimbursement for losses suffered due to the disaster."

Did you inform the Government of the moneys that you received?

Mr. SEGARS. No, sir.

Senator WEICKER. You did not?

Mr. SEGARS. No.

Senator WEICKER. Now you indicate to us that you dispute the excess crop payment.

Mr. SEGARS. Yes, sir.

Senator WEICKER. Senator Dixon, what is the excess payment?

Senator DIXON. $112,921.

Senator WEICKER. $112,921. I should think if anybody came up to me and we had a difference of $112,000, I might do something about it. You are telling me that you were informed of this a year ago and yet it is only now that you are telling the committee that you disagree.

Mr. SEGARS. The correspondence I received refers to $73,829. I do not know where the $112,000 comes from.

Senator WEICKER. That is adding in the $39,000 which you failed to disclose. Let us say $73,000. If somebody notified me of a $73,000 difference, I think I might get to the businss of disputing it. Why wait a year?

Mr. SEGARS. I really have no reason for having waited. We cannot repay it, but I would be happy to resolve it with whomever I need to resolve it with. It would be no problem on my part for us to resolve it.

Senator WEICKER. I gather you have that opportunity because you have been written to several times in the sense of asking that you make payment.

Mr. SEGARS. I believe we have only received it one time, but we did receive it one time.

Senator WEICKER. It is your contention that the $55,000 which was spent on commodities futures did not come from this Government loan. Is that correct?

Mr. SEGARS. It is in our total funds. I do not have but one bank account to operate from. We operate from one bank account. It came from that. As I said, I can substantiate moneys coming back into the account. It would essentially be the same amount. It may not be the exact same amounts, but that is what hedging does in the first place. It eliminates speculation.

Senator WEICKER. Were it not for the Government loan would you have had the money to make this hedge?

Mr. SEGARS. I do not know, sir. I probably would have. I feel sure I would have. They were made all along. It was not made in one lump sum as a result of the loan. The loan had no bearing on that phase of the business operation. It just happened to be a technical point of timing.

There again, there is certainly no intent on my part to do wrongly toward the specific agreement of the loan or terms of the loan. There was certainly no intent on my part to abuse that in any way, shape, or form.

Senator WEICKER. How many payments have been made on this loan?

Mr. SEGARS. I believe two, sir. It is delinquent now.

Senator WEICKER. This is also in light of your latest net worth statement that you have here listing a net worth of $2.7 million?

Mr. SEGARS. That was back prior to the making of this loan, I believe, and prior to the crop years of 1977 and 1980 which have been totally disastrous to my business operation.

Senator WEICKER. Senator Nunn?

Senator NUNN. Mr. Segars, on this commodities futures account, what commodity was that?

Mr. SEGARS. It was probably soybeans, sir. I am not really sure.

Senator NUNN. Do you remember what month of the year it was in and what year it was that you expended this?

Mr. SEGARS. It was in April, I believe.

Senator NUNN. April of what?

Mr. SEGARS. 1978.

Senator NUNN. 1978?

Mr. SEGARS. Yes, in March, April, May, along in that time.

Senator NUNN. Were you selling or buying?

Mr. SEGARS. Probably doing some of both, sir.

Senator NUNN. Do you consider that a hedge or a speculation?

Mr. SEGARS. Whichever we did, if I purchased some from someone, then I would make a sale in the futures. If I made a sale, I would make a purchase.

Senator NUNN. However, this was not relating to your farm growing? It was relating to your buying and selling operation? Do you buy and sell farm commodities?

Mr. SEGARS. Yes.

Senator NUNN. That is part of your business?

Mr. SEGARS. Yes, sir.

Senator NUNN. You also grow crops?

Mr. SEGARS. Yes, sir.

Senator NUNN. Was this related to the growing? Was it a hedge against crops you were growing or was it a hedge against purchases or sales you had made from other farmers?

Mr. SEGARS. It was against purchases and sales of other crops.

Senator NUNN. Do you also hedge your own crop?

Mr. SEGARS. At times, yes, sir.

Senator NUNN. Do you recall whether you made or lost money on this hedge? Was it indeed a hedge or was it simply a break-even proposition?

Mr. SEGARS. It should have been close to it. If you are familiar with grain trading, a basis enters into it also and you there is no way to hedge a basis, but it should be close to it. It should not have been much one way or the other.

Senator NUNN. Actually this would have been a wash?

Mr. SEGARS. An approximate wash; yes.

Senator NUNN. Would it be fair to say that this hedging operation did or did not jeopardize your ability to repay the loan?.

Mr. SEGARS. It should have helped me because I would hope I made a profit on the transaction of the actual grain being traded.

Senator NUNN. Do you keep your warehouse and your purchasing from other farmers together with your own bank account? It is all one bank account?

Mr. SEGARS. Yes, it is all one bank account. We keep separate accounts in the books, but it is all one bank account.

Senator NUNN. How much is normally in that bank account? Are you talking about $200,000 or $300,000 at the time?

Mr. SEGARS. Oh, no, sir; $10,000 or $20,000, something of that nature.

Senator NUNN. Obviously, you either purchased or sold about $55,000 worth of some form of grain before you made this commodity hedge. Is that right?

Mr. SEGARS. This was a cumulative total. It was not all one transaction. That figure is not all one transaction.

Senator NUNN. This was over a period of time, then?

Mr. SEGARS. Yes, sir.

Senator NUNN. What kind of losses have you sustained overall in the last 3 or 4 years? You say your net worth statement was $2.7 million?

Mr. SEGARS. I think that may have been a total of personal and the company.

Senator NUNN. Would your net worth still be over $1 million?

Mr. SEGARS. No, sir; the company's would not be.

Senator NUNN. How about personal?

Mr. SEGARS. Somewhere in there. I doubt if it would be that good.

Senator NUNN. Do you keep your corporation separate from your personal?

Mr. SEGARS. Yes, sir.

Senator NUNN. Did you guarantee this SBA loan personally or was it simply a corporate signature?

Mr. SEGARS. I believe so, sir. I am not absolutely certain, but I believe I did.

Senator NUNN. How much are you delinquent? How much do you owe now?

Mr. SEGARS. Just one payment.

Senator NUNN. How much would that payment be?

Mr. SEGARS. I think it is $46,325.

Senator NUNN. Would it not be possible for you to bring that loan up to current standing?

Mr. SEGARS. Not at the present time; no, sir.

Senator NUNN. Is that a cash flow problem?

Mr. SEGARS. Yes; sir, it is a cash flow problem.

Senator NUNN. It is not an asset versus liability problem? You are not bankrupt now?

Mr. SEGARS. No, sir.

Senator NUNN. Could you not sell some assets if the Government were to insist that the money were to be repaid?

Mr. SEGARS. It would be difficult, sir. It is tied up in farmland and farm equipment.

Senator NUNN. What would happen if the Government started foreclosing?

Mr. SEGARS. I do not know, sir.

Senator NUNN. Does the SBA have security—a first mortgage on anything?

Mr. SEGARS. Yes, they have security on land.

Senator NUNN. First mortgage or a second mortgage?

Mr. SEGARS. I believe they are second.

Senator NUNN. If they started foreclosing, you could find a way to get out the money, could you not?

Mr. SEGARS. I do not know, sir. This last year was some kind of tough year.

Senator NUNN. I know that. I have sympathy with everybody who lost money. I know about that problem very well.

Mr. SEGARS. We never made as low a yield as we made last year since I have been in business.

Senator NUNN. The problem we are facing now, Mr. Segars, is a general problem, and that is the disaster loan money has just been cut very, very severely. A lot of farmers who came along and lost money in the 1980 crop year are not going to be able to get any credit from the Government on disaster.

Mr. SEGARS. That is what bothers me. I do not know that you were in the room when I mentioned the current prices. I think you are familiar with peanut crops I do have peanut acreage. We have 386 acres of peanuts. I am sure you can relate to that acreage. They look good. I have had some of it under irrigation. We have had pretty good weather on it and they look real good. Of course, the prices are supported on peanuts and we think we can get a reasonable price. Some of them have already been contracted.

However, it is different with these other crops. I referred to a 100 bushels of corn and not even breaking even or not even making a profit. That is just not good. It looks that way for soybeans, too. It looks like we will make a good yield of soybeans.

If we can continue to control the insects in cotton and if we do not get into too much of a rot problem with the rainfall, then maybe it will be good. However, you know it is not done until it is harvested and is sold. It looks so much brighter than it has in the past, but the prices look terrible. They look really bad.

Senator NUNN. I agree with you on that, too.

What percentage of the farmers in your area are in distress now financially?

Mr. SEGARS. I would not know how to address that, sir, but there are more than myself. I know that. I know I am not alone. Misery loving company does not help the situation.

Senator NUNN. Mr. Segars, one thing I think is important for you and others who have these disaster loans to realize is the only reason this program has been able to be in existence is because the Government was willing to come to the aid of farmers in distress. When farmers who can pay this loan back, even though you might have to sell something, but when you can pay it back and you are not paying it back and the delinquency is there, it has a tremendous effect on whether other people who are in dire distress and have no way of selling assets or doing anything can even get an additional loan.

We are in a real budget squeeze now. Unless this money is paid back in, it is not going to be available for other people who may go bankrupt because other farmers who could pay it back are not paying it. I hope you keep that in mind. I think SBA has to keep it in mind.

I do not want to see anybody foreclosed on, but when there is adequate security there and when there are ways that you could pay the loan back and it is not being paid back but is delinquent, it is not just you that is affected. There are other farmers.

Mr. Segars. There is not a day or night that goes by that I do not worry about it very much, sir. I know it needs to be done. I know a person's credit is valuable. It is not good. It is just something that I cannot help. It is just a situation that cannot be helped due to last year's crop as much as anything. If we could just get going and get our heads up again one time, I think it would certainly be a better situation for us. However, we cannot do it alone.

Senator Nunn. However, you cannot do it with the price of soybeans and corn and wheat. I know that and I completely agree with that.

Mr. Segars. I urge you to look at today's Wall Street Journal at the cash prices of a year ago and today. I will not belabor the committee in saying them again, but they are not right.

Senator Nunn. Thank you, Mr. Chairman.

Senator Weicker. Thank you, Senator Nunn.

Again, I want to just summarize what it is that is involved here. I want to make clear it is not just one delinquent payment. I gather your delinquent payment is $48,000 or thereabouts from what you told the committee.

Additionally, you received a $39,000 grant. This is not a loan. This was money that was given to you by the Government of the United States for this disaster that you do not have to pay back. Is that correct?

Mr. Segars. Yes, sir.

Senator Weicker. Which you accepted as payment for this disaster. Then you attested to the U.S. Government that you had received nothing even though you had received $39,000.

Also involved is $73,000 which you say you have some quarrel with although you have not exercised your rights to quarrel with it for nearly a year now. The $73,000 is in excess crop payments.

That is a total of $160,000. A delinquent payment of $48,000, the $39,000 which you received in the way of a grant, and a $73,000 excess payment. Therefore, $160,000 was either wrongfully taken from this Government or has not been paid back to the Government. What if every farmer in the United States went around to the tune of $160,000 doing that number? There would not be any money for the legitimate needs of the farm community of this Nation. That is the dispute that this committee has.

I have no further questions. Are there any questions of the witness?

Senator Nunn. Mr. Segars, let me ask you one other queston. Do you personally have any expectation that the SBA is going to forgive this debt?

Mr. **Segars**. No, sir. As I stated in my opening comments, I do not know any farmer in my area that does not expect to repay it. This is a loan.

Senator **Nunn**. That is what it was intended to be and that is what it is. I do not think any farmer ought to have that expectation.

Mr. **Segars**. No, sir. I do not know of anyone. We feel like we are fortunate. Personally, I feel I am so fortunate to have the loan at the interest rate that it is with interest rates where they are today and no signs of getting better. Here again, I find myself in the position of I cannot make that payment with the situation as it is with last year's crop and looking at current crop prices. It is just not a good situation. We worry about it a whole lot. I am not alone in my worry.

I want to say this. These were made as disaster payments. I had a disaster. That is why I was entitled to anything in the first place. It really was not enough to go into a new crop. Half of that $485,900 went to pay back on the operating debt from the prior year and half of it to forward. That did not carry a crop of my size forward, but I got what I was entitled to have as we discussed.

Senator **Nunn**. Thank you, Mr. Chairman.

Senator **Weicker**. Thank you, Mr. Segars.

The next witness is Mr. Thomas E. Davis.

Mr. Davis, raise your right hand. Do you swear to tell the truth, the whole truth, and nothing but the truth, so help you God?

Mr. **Davis**. I do.

Senator **Weicker**. Mr. Davis, I want to thank you for appearing before the committee today. The Inspector General and Department of Justice concluded an investigation on your loan, and the allegations concerning the loan are extremely serious. You apparently received duplicate loans from two separate Federal agencies for the identical disaster loss and misused a large portion of the loan proceeds for, among other things, buying land, rebuilding a house, and making payments on a boat.

Before asking any specific questions, I would like to give you an opportunity to respond to the rather serious charges we have heard today.

Mr. Davis, under the rules of procedure of the Senate Committee on Small Business, your attorney may be present during your testimony. You have the right to consult him before answering any questions. Do you have an attorney with you today?

TESTIMONY OF THOMAS EARL DAVIS, BLAKELY, GA

Mr. **Davis**. No; I do not. A Federal marshal came out to the peanut field and gave me a subpena. I got in about 12:30 last night and caught a plane this morning early.

Senator **Weicker**. Is it your position that you would like to have an attorney with you prior to any questions by the committee?

Mr. **Davis**. I can answer some of the questions, too, because a bunch of the stuff he has written down has nothing to it. If he had waited a little while and checked the records on the farm again, he would have seen it differently than what he saw.

Senator **Weicker**. As I have indicated, in addition to your rights as a witness, you also have an obligation while testifying before this committee to testify truthfully, as you have sworn to do. If you do so testify, you are obligated to provide truthful answers so as not to subject yourself to the laws and penalties regarding perjury.

In addition, in the event you do decide to testify, anything you say can be used against you in any other proceeding. Do you understand your rights and obligations as a witness before this committee?

Mr. DAVIS I do.

Senator WEICKER. Are you satisfied to testify before this committee without an attorney?

Mr. DAVIS. I will testify on what I know and on what actually happened.

Senator WEICKER. Is there any statement that you care to make prior to any questions of the committee?

Mr. DAVIS. No.

Senator WEICKER. Mr. Davis, you were not here while the Inspector General traced the use of the SBA loan proceeds. Since you were not here, would you care to have the Inspector General to repeat while you are here his findings as to your loan?

Mr. DAVIS. I read a little piece of paper awhile ago.

Senator WEICKER. I think what I would like to have is Mr. Boucher to come to the stand and review or restate his statement on the Davis loan.

Mr. BOUCHER. Mr. Chairman, in essence, as I testified before, our investigation was initiated in May of 1978 on receipt of information from the Atlanta district office which indicated that Mr. Davis had received duplicate disaster loans from SBA and FmHA.

Our investigation disclosed that Mr. Davis received a $330,000 disaster loan from FmHA on January 4, 1978, and the very next day received partial disbursement on an SBA loan of $194,900, all for the same disaster loss. Mr. Davis failed to disclose the FmHA loan to the SBA and also pledged the same collateral to secure both loans.

In addition to the foregoing, our investigation disclosed that Mr. Davis misused $132,500 of the SBA loan which had a 3-percent rate of interest when he purchased land, extensively remodeled his own residence, and placed money in a personal savings account. He was to have used these funds for farm debt payment and planting the following year's crop.

In July 1978 this matter was referred to the Atlanta district office for appropriate action and the U.S. attorney's office in Macon, Ga., for prosecutive determination.

As required by the terms of the loan agreement, in October 1978, Mr. Davis did send a check for $16,327 as his first payment on the SBA loan. That check bounced. To date, there have been no payments made on the $194,900 SBA loan.

In October 1978, the district office advised that due to violations of the terms and conditions of the loan agreement, the loan was declared to be in default. The matter was referred to the civil division of the U.S. attorney's office in Macon, Ga. In July 1979, the U.S. attorneys office declined prosecution of Mr. Davis.

These facts were brought to the attention of the Criminal Division of the Department of Justice in June 1980. The matter is still under active consideration by the Department.

That is what I testified to the first time, sir.

Senator WEICKER. Mr. Davis, on January 14, 1978, you received a $321,000 loan from FmHA. The very next day, you executed documents at SBA in order to receive a $194,900 loan for the same disaster loss. When did you first become aware that you were not entitled to receive duplicate loans for the same loss from both FmHA and SBA?

Mr. DAVIS. I applied to SBA first. Then I am not going to get that. So then I turned around and applied to FHA (sic). It rocked on and rocked on. After they approved the loan, I told them. There was nothing ever said about anybody deflating anything. Nobody in that part of the country heard anything about it, I reckon.

I sent a letter to SBA that I had applied for an FHA loan. I did not hear anything else about it for a long time.

Senator WEICKER. Mr. Davis, you executed an affidavit for the SBA loan on January 5, 1978, and you did not list the FmHA loan.

Mr. DAVIS. Nobody asked me if I had an FHA loan.

Senator WEICKER. This is your affidavit: "Deponent further states that there are no unpaid or unsatisfied security deeds, mortgages, claims of lien, special assessments for sewage or street improvements or taxes which could constitute a lien againt said land, except:" and there is nothing in here about the FmHA loan. How do you explain that?

Mr. DAVIS. I do not know.

Senator WEICKER. You do not know?

Mr. DAVIS. To the best of my recollection, there was a stack of paper about this big.

Senator WEICKER. Do you not think that is a little bit important? Do you not think somebody would remember when they had done something just the day before, 24 hours earlier? Is a $321,000 loan something that in a matter of 24 hours you just forget about?

Mr. DAVIS. I will tell you what. You can lose a pile in farming.

Senator WEICKER. I am sorry. I did not understand you.

Mr. DAVIS. I said you can lose a pile of money farming.

Senator WEICKER. I think that there is nobody on this committee who would disagree with that statement. This committee has involved itself in making sure that money is available to the farm community of this Nation for purposes as written by the law.

Just tell me how we are going to distribute the smaller and smaller pot when people go in and get a $321,000 loan over here and then come back and get another $194,000 loan for the same thing 24 hours later, not telling anybody about the $321,000 loan? How is that going to go ahead and help the farm community which is having a difficult time making any money?

Mr. DAVIS. I do not know.

Senator WEICKER. However, that is what you did. Do you think you are helping your fellow farmer in that regard? You are helping yourself. I do not doubt that.

Mr. DAVIS. I do not know.

Senator WEICKER. How much of the SBA $194,000 loan have you paid back since you got it 3½ years ago?

Mr. DAVIS. Nothing. I sent them one check and it bounced.

Senator WEICKER. You have not paid anything back?

Mr. DAVIS. I have not made anything with which to pay it back. I have not shown a profit at all, or even close to it since then.

Senator WEICKER. Senator Nunn?

Senator NUNN. Mr. Davis, no one at SBA said anything to you during the whole course of your loan application or signing of the loan about the Farmers Home Administration?

Mr. DAVIS. Nobody.

Senator NUNN. And nobody at the Farmers Home Administration said anything to you about SBA?

Mr. DAVIS. No, sir.

Senator NUNN. Did you recognize that you were getting two loans for basically the same loss?

Mr. DAVIS. Well, I needed more money than what I was getting. The fellow at the FHA office would not let me have enough for what I was needing.

Senator NUNN. Did you think you had gotten less than the full amount of your loss? Is that the reason you applied?

Mr. DAVIS. I did get less than the full amount. The way he did it and all, I did get less.

Senator NUNN. How much was your full loss?

Mr. DAVIS. It was around $400,000, the best I can remember.

Senator NUNN. How much did you get from FmHA?

Mr. DAVIS. It was $321,000.

Senator NUNN. How much did you get from SBA?

Mr. DAVIS. $194,000. I believe that is right, but the money was to be used, too, as operating money the next year. That was not all just straight disaster money now.

Senator NUNN. It was supposed to be, was it not?

Mr. DAVIS. That is for the FHA, but it was not. It was to be used as operating money.

Senator NUNN. Which one was, SBA or FmHA?

Mr. DAVIS. A bunch of the FHA money was used as operating money.

Senator NUNN. Did they make that clear to you?

Mr. DAVIS. Yes.

Senator NUNN. That FmHA loan was $321,000. How much of that was operating versus disaster loss?

Mr. DAVIS. I believe $185,000, or something of that nature.

Senator NUNN. Was for what?

Mr. DAVIS. Operating.

Senator NUNN. For the next year?

Mr. DAVIS. For the next year, and that was not enough to operate on.

Senator NUNN. Therefore, if you subtract $185,000 from the $321,000, you are saying $136,000 of that $321,000 was for disaster loss?

Mr. DAVIS. I believe it was $185,000 that was to be used as operating cost out of there.

Senator NUNN. It was your interpretation of what you were doing then was getting part of the FmHA loan for operating the next year and that that had nothing to do with your disaster?

Mr. DAVIS. Yes, sir.

Senator NUNN. Mr. Boucher, have you looked at those FmHA administration papers?

Mr. BOUCHER. Some of them, Senator Nunn.

Senator NUNN. Could you take a seat just a minute here? I want to ask you another question.

Mr. DAVIS. It looked like it was all done with the disaster money, but, see, I had to use a lot of operating money out of it.

Senator NUNN. Could you comment on that and as to whether you looked at the percentage of that FmHA loan that was anticipatory for operating expenses versus what was disaster?

Mr. BOUCHER. I can only say what SBA authorized its funds to be used for. I can note, however, Senator Nunn, that in his SBA loan application, he listed the following liabilities: PCA, $197,000 to be paid; Peoples Bank, $49,000 to be paid. SBA authorized funds to make those payments, but not in total to PCA. It was $48,000 to PCA and $48,000 to the Peoples Bank. That is why we made the loan. We loaned him $97,450 for the next year's crop.

Our investigation disclosed that he actually used the FmHA loan proceeds to pay in full the PCA debt of $185,000 and $47,000 to Peoples Bank. He used a total of $232,000 out of the $330,000 to pay off debts that he told SBA he was going to use its money to pay.

Senator NUNN. What was the actual SBA money used for then?

Mr. BOUCHER. Let me back up a little bit if I could. We gave him $194,900 to be used as authorized: To PCA to pay off $48,725; to pay off the Peoples Bank at $48,725; and $97,450 for next year's crop.

In effect, we visited with Mr. Davis. Mr. Hamilton of my staff visited with Mr. Davis. I would note that when questioned by Mr. Hamilton in June of 1978 when Mr. Hamilton explained why he was there, Mr. Davis volunteered at the very outset of the interview that he figured he was in trouble, he knew he would have to give the SBA money back, but he did not know how he could do so.

Mr. Davis thereafter cooperated with Mr. Hamilton. He explained to our investigator that he had deposited $174,900—that is $20,000 less than authorized—of the SBA money into a savings account which had no previous balance and no deposits other than the proceeds of the SBA loan. He gave us a copy of the savings account passbook.

The remaining $20,000 went into a checking deposit which at the time of deposit had an overdraft of $7,000. This deposit of $20,000 left a balance of $13,000. He then wrote an $18,000 check for fertilizer, again causing an overdraft of $5,000.

Mr. Davis then explained to us and showed us checks, and so forth, that the $174,900 in the savings account was used for the following purposes. He advised that he used $90,000 to buy several hundred acres of new farmland. He used $22,666 to make improvements on his home, to make two boat payments, and survey and clear land.

At the time of our interview, I would note that there was $19,900 left in the savings account, which brought us basically to what we believe to be a total misuse of the SBA funds of $132,566. The balance between $132,000 and $194,000 was used for crops and farm related expenses.

Senator NUNN. Mr. Davis, do you want to respond to that?

Mr. DAVIS. Yes. I do not have any figures with me. I just jumped on up here this morning. I took a check for $90,000 and bought 132 acres of land, but if they would go back and look forward on through that year's bank statement, the money was put back into the account through the sale of cows, wheat, and all this stuff during the time.

Senator NUNN. What does that have to do with it?

Mr. DAVIS. What does it have to do with what? With the money. That is what is has to do with.

Senator NUNN. I do not understand. You took $90,000 to buy land. That was supposed to be used for other purposes according to——

Mr. DAVIS. It was to be used for operating money. I put the money back in.

Senator NUNN. From the sale of crops?

Mr. DAVIS. Yes.

Senator NUNN. Was not the sale of crops money supposed to be assigned to the Production Credit Association?

Mr. DAVIS. No.

Senator NUNN. How do you pay back Production Credit? Do you not owe Production Credit?

Mr. DAVIS. Not now I do not.

Senator NUNN. Did you then?

Mr. DAVIS. No, not at that time.

Senator NUNN. Nobody has a lien on your crops then? That money just goes into your bank account?

Mr. DAVIS. Back then, yes, FmHA had a lien on the crop.

Senator NUNN. You did not pay FmHA that money back?

Mr. DAVIS. Yes, I paid them back. I paid them back that fall.

Senator NUNN. How does that then reimburse for the land purchase if the money went to FmHA?

Mr. DAVIS. What I was saying was as a monthly statement on the checking account, there were cows sold, hogs sold. I was feeding a lot of hogs back then and all. It was transferring through the account every month. That is what I said about it.

Senator NUNN. Did you think you were authorized under the SBA loan to use the $90,000 for the purchase of land?

Mr. DAVIS. I did not, really.

Senator NUNN. You did not really think so?

Mr. DAVIS. I do not really think so now. After it was all over with, when the fellow came down there that day, after I got the second check, I kept it and kept it and kept it. It stayed there a long time.

Senator NUNN. You can see how the people who are looking into this would wonder how that money would go to purchase land and how someone in a distressed situation would be able to go out and purchase land.

Mr. DAVIS. Senator Nunn, you know, you all are talking about all of this stuff. I wish some day you would just come down and just stay with some of us for about 2 to 3 days and find out all this stuff. Then you would understand a lot more. Of course, you have farmed before.

Senator NUNN. I understand the losses. I understand the need for disaster money. I think if we had not had the disaster money in the State of Georgia during this timeframe that about two-thirds of our rural areas would have gone under, not just farmers but bankers and everybody else.

However, the problem is the whole program gets in disrepute when somebody borrows money on a disaster situation and then goes out and buys land and then puts it in a house. That is where the problem comes. That is the reason we do not have a disaster program any more to speak of. People who have credit now cannot get a disaster loan except at the current rate of interest, which is almost impossible to pay back. It is this kind of thing that has caused the whole program to fold.

Looking back on it, do you think it was the right decision to be made, morally right—forget about the legal implications—to use that kind of money, the disaster money, to go out and buy land?

Mr. DAVIS. Not at this time, I do not, but back then was another thing. I can look back now and see where I messed up, but you cannot see tomorrow. You cannot see tomorrow. I mean, you do not know what you are going to do tomorrow or what is going to happen tomorrow.

Senator NUNN. Did you really feel like you could afford to go out and put $60,000 in remodeling a house?

Mr. DAVIS. I did not put that much money in the house.

Senator NUNN. OK, it was $34,000.

Mr. DAVIS. I had to have somewhere to live. I was living in a barn at that time.

Senator NUNN. That was for your own residence?

Mr. DAVIS. I was not living on my own land. I was living on somebody else's land, some land I had leased. The lease had run out and I had to do something. I had to either move to town or remodel a house. That is what I did. I remodeled the house. I took farm help and we remodeled the house when it rained that fall and spring. We did it ourselves.

Senator NUNN. Are you still farming now?

Mr. DAVIS. Yes.

Senator NUNN. What kind of crops do you have this year?

Mr. DAVIS. I have about 300 acres of peanuts, about 1,000 acres of beans, and a couple hundred acres of corn.

Senator NUNN. How are they doing this year?

Mr. DAVIS. We are in a streak there where we have been getting some rain, but not much. Right above us is not getting any and right below us is getting it every day.

Senator NUNN. Are you going to be able to make it this year?

Mr. DAVIS. I hope I do.

Senator NUNN. How far behind are you on your SBA loan now?

Mr. DAVIS. Three payments, or however many years it's been.

Senator NUNN. You have not made a payment for 3 years?

Mr. DAVIS. No.

Senator NUNN. What kind of security does SBA have?

Mr. DAVIS. They have a note on all the land and all the equipment.

Senator NUNN. How many mortgages are in front of them?

Mr. DAVIS. Two.

Senator NUNN. They have third mortgage?

Mr. DAVIS. Yes.

Senator NUNN. If the first and second mortgages were completely paid off out of a sale of land and equipment, would there be any money left?

Mr. DAVIS. I think they are covered with it just like it is.

Senator NUNN. Do you think they have enough collateral?

Mr. DAVIS. That is right.

Senator NUNN. Do you believe you are going to be able to catch up on those payments this year?

Mr. DAVIS. I hope I do. That is everybody's hope. We are in the midst of peanut season right now. We have about 100 acres on the ground.

Senator NUNN. Looking back on it, you think it was a mistake to have used the proceeds in this fashion, but you did not think so at that time.

Mr. DAVIS. I do. When the fellow first came down and checked me, I asked him if he wanted me to pay the money back then when he jumped on me about that. I do not even remember who he was, but he can tell you the same thing. That was when I could do it. Do you know what I am talking about? It was when I could do it.

Senator NUNN. You could not do it now without selling out?

Mr. DAVIS. I could not do it now. I could not even buy a plane ticket up here right now. That may sound bad, but that is the truth. That is just how bad it is.

Senator NUNN. Thank you, Mr. Chairman.

Senator WEICKER. Senator Dixon?

Senator DIXON. Mr. Davis, you received from FmHA $321,000. Is that correct?

Mr. DAVIS. Yes.

Senator DIXON. And $194,900 from the SBA?

Mr. DAVIS. Yes.

Senator DIXON. You knew, did you not, that the $194,000 you were receiving from the SBA really covered three things: $48,725 that you owed the PCA, $48,725 you owed the Peoples Bank, and $97,450 for planting next year's crops? Is that not what it was for?

Mr. DAVIS. Yes.

Senator DIXON. In the money you received from the FmHA, you also received in that lump three separate checks covering the money you owed the PCA and the Peoples Bank, did you not?

Mr. DAVIS. Yes.

Senator DIXON. Then you took the FmHA checks that were made payable to the PCA and the Peoples Bank and you took them to those separate financial institutions and you had them endorsed back to you, did you not?

Mr. DAVIS. Yes, because they were made jointly.

Senator DIXON. So you knew that you got money from two different Federal agencies twice for the same two debts. Is that not true? Well, you must have known that was not right?

Mr. DAVIS. All right, listen. Well, I did not mean to cut in on you.

Senator DIXON. That is all right. Cut in on me.

Mr. DAVIS. All right. Those debts had been paid. They had just been paid. The fellow in Albany—I do not remember who he was—told me if the debts had already been paid, all you had to do was to get them to countersign the checks and pay bills with them for operating money.

Senator DIXON. I understand that. Those debts had been paid by the SBA loan. They gave you checks. You also got checks from the FmHA for the same debts. Since you had already paid the debts with this money you got from the Federal Government, you took that money you got from the Federal Government and had them endorse those checks back to you, and you took those two checks totaling $97,000 and put them in your own account. Is that not true?

Mr. DAVIS. Yes.

Senator DIXON. Surely you knew the Government gave you the money twice if you did that. Is that not so?

Mr. DAVIS. Yes, you could say that. You got to look at the opposite end. I did not get enough on the disaster.

Senator DIXON. The only thing I am trying to say, Mr. Davis, is you understood you had separate checks, two separate checks, for each of those separate debts. You took of the checks for the separate debts, gave them to the institutions, took the other two checks for the separate debts, took them to the same institutions, had them endorse them and give them back to you, and you put them in your pocket and put them into another account for you. You surely knew that was not right.

Mr. DAVIS. I do now.

Senator DIXON. However, you knew at the time.

Mr. DAVIS. I did not even think about it at the time. I mean right now I know that.

Senator DIXON. I have nothing further.

Senator WEICKER. I have no further questions. I think it is a little discouraging to men like Senator Nunn who have been out here championing this disaster program on behalf of farmers to hear this kind of testimony. It certainly does not make his role any easier when he has to fight for it again.

I know there are many of us who come from nonfarming States who realize the very special difficulties the farm community has had over the years. This country is very dependent on that community. What I have heard today in many respects, both your testimony and other testimony, is just plain wrong. The purpose of these hearings is to make sure that what we do is to get some help to where it is needed.

Do you have any further statement to make, Mr. Davis?

Mr. DAVIS. No.

Senator WEICKER. The hearings will recess until tomorrow morning at 9:30.

[Whereupon, at 1 p.m., the committee recessed, to reconvene on Thursday, September 10, 1981, at 9:30 a.m.]

SBA'S FARM DISASTER LOAN PROGRAM

THURSDAY, SEPTEMBER 10, 1981

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The committee met, pursuant to adjournment, at 9:30 a.m., in room 424, Russell Senate Office Building, Hon. Lowell Weicker, Jr., chairman of the committee, presiding.

Present: Senators Weicker, Nunn, and Dixon.

Also present: Robert J. Dotchin, staff director; R. Michael Haynes, chief counsel; Alan L. Chvotkin, chief counsel, minority; Marc Smolonsky, investigator; John G. McLean, professional staff member; William P. Goodwin, Jr., special counsel, minority; and Margaret M. Broadbin, hearing clerk.

STATEMENT OF HON. LOWELL P. WEICKER, JR., A U.S. SENATOR FROM THE STATE OF CONNECTICUT, AND CHAIRMAN, COMMITTEE ON SMALL BUSINESS

Senator **WEICKER**. Today this committee continues hearings into the Small Business Administration's $3 billion farm disaster loan program. Yesterday we heard testimony regarding the alarming abuses that have occurred in this program since 1977.

Millions, potentially hundreds of millions of dollars are immediately owed to the Treasury as a result of these abuses. The Government intends to identify and collect these excessive and duplicate loan proceeds.

The Office of Management and Budget, the Federal Emergency Management Agency, and the top officials of the SBA will testify today about possible solutions to this collection problem.

Our first witness will be Mr. Edward Harper, the Deputy Director of the Office of Management and Budget.

My comments here apply to all the witnesses. All the statements in their entirety will be included in the record following each witness' appearance.

Mr. Harper, you may proceed with your statement in any way you deem appropriate.

STATEMENT OF EDWARD L. HARPER, DEPUTY DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. **HARPER**. If I may, I will submit the written statement for the record and just summarize it to expedite the proceedings here.

Thank you very much for giving us the opportunity to participate in the discussion of what we feel is a very important topic. The topic of debt collection is much more than an academic topic at the Office of Management and Budget because our fiscal 1982 target involves the realization of collecting $1 billion in delinquent debts owed the Government. If we fail to realize that target of $1 billion the deficit will expand by that amount in fiscal year 1982.

One important aspect of our efforts in this area is to realize the passage of the Debt Collection Act of 1981, Senate bill 1249. We feel this would be an important assist in allowing us to achieve that target.

This is an important problem. It is a large problem; $175 billion is owed the Government. You will notice that that figure is as of September 30, 1979. That is old data. What that old data represents is the fact that the Government's data collection system governmentwide for what has happened to our debts, what is owed the taxpayers of this country, is seriously inadequate.

We are in the process of making significant changes there so we will know on a current basis what is owed the Government and what is delinquent. That figure of $175 billion we estimate has probably increased some 9 percent in fiscal 1980 to about $191 billion. We would estimate that it has probably increased beyond that point today.

Our lack of information is a serious problem in debt collection. Other problems are that insufficient resources have been allocated to the problem of debt collection. Oftentimes in the past, program managers have been rewarded not for collecting debts or collecting loans but instead for making them: Get the money out the door and do not worry what happens once it leaves your hands.

Another problem we have had is insufficient litigative activity to recover debts which are clearly owed the Government and which people are dragging their feet or throwing up other obstacles to the Federal Government realizing the proper recoupment of loans made.

Also, there are some regulations and laws which inhibit the efficient collection of Federal debts. With respect to executive branch actions, the President has directed that we institute an aggressive program to collect the debts properly owed the Government. At his direction, we have asked for each of the major Federal agencies to prepare preliminary action plans as to how they can collect these debts. At this time, the Office of Management and Budget is reviewing these plans and will monitor their implementation.

If I may take a moment on the debt collection legislation, we feel that this is a very important piece of legislation. It will give us some of the tools which the private sector presently has to more effectively collect debts. For example, one of the things we would like to do is to have the ability to offset delinquent debts of Federal employees against their salaries. At this time, that is impossible.

One interesting example is that a computer matching survey was recently run by the Inspector General of the Veterans' Administration. What he matched was people who were delinquent in debts owed the Veterans' Administration versus current Federal employees. They found that some 66,000 current Federal employees owe the Federal Government some $37 million. At this time, we have no more than moral suasion to encourage these Federal employees to pay their debts to the Federal Government.

In that legislation, we are also asking that the IRS be given permission to disclose addresses to private sector contractors who would be assisting Federal agencies in collecting debts justly owed the Government. The legislation contains ample safeguards of any financial information or any other confidential information, but it has been found that the quality of the address list of the Internal Revenue Service is far superior to that which we could obtain from any private sector source. Allowing us to do this could by itself enable us to realize some $360 million that would otherwise be difficult or impossible to realize in a fairly short term.

One of the other important issues which we feel should be cleared up in legislation is precisely that of allowing Federal agencies to contract for private sector collection services. The past Comptroller General and the Justice Department agreed that, in general, Federal agencies had the right and authority to allow for the contracting of private sector collection agencies operating under the strictures of the Fair Credit Practices Act to collect debts owed the Federal Government, outside of course of tax debts which exclusively would be handled by the IRS.

However, it is unclear in some areas. That is also the case with respect to the Small Business Administration. Thus, the legislation would attempt to clarify that specific issue of allowing Federal agencies to contract out for collection services. We feel that this is an important opportunity to efficiently collect debts at the lowest possible cost to the Federal taxpayer, and to recoup those moneys due the Federal taxpayer in effect through his Government.

The SBA farm disaster loan program is the specific subject of this morning's meeting. Our goal at the Office of Management and Budget is to strengthen the management of this Small Business Administration program generally and specifically.

For example, some of the things we have done is to approve 99 temporary employee positions. Earlier this year we had provided another two dozen permanent employee positions to the Inspector General's Office in the Small Business Adminstration.

We have also sought to encourage the SBA to use administrative offsets, a device used effectively by the Department of Defense, to recover funds owed the Government when other business transactions were transacted between a debtor and the Federal Government.

We have also encouraged and assisted the SBA attorneys in gaining designation as special assistant U.S. attorneys. We have also encouraged the SBA Inspector General to expand the audit of farm and disaster loans.

Finally, during the review of our 1983 budget, we will include an evaluation of the SBA debt collection efforts, the resources allocated to that, and, as necessary, perhaps propose additional legislation to authorize the SBA to contract with private sources for debt collection services.

We feel overall that this is a very important topic not only for the SBA but for the American taxpayer because we find that when you take just those delinquent debts owed the Federal Government, the average taxpayer in this country, collectively, is having to come up with $10 million a day in interest charges that he would not otherwise have to pay simply because there are some people who are looking for a free ride, who are failing to pay their debts justly owed the Federal Government.

Part of that is simply because in the past, we have done an ineffective job of contacting people, reminding them that in fact they owe the Federal Government repayment on that loan, that the loan was not a permanent grant, a free gift from the Government, that it was something their fellow taxpayers lent them, and that in all fairness to all taxpayers, those loans need to be repaid promptly.

Mr. Chairman, that concludes my statement. I would be glad to respond to any questions which you or your colleagues may have.

Senator **Weicker**. Thank you very much, Mr. Harper.

Let me get right to the business of what we were confronted with yesterday. I understand you have proposed to assign 99 personnel to the Southeastern region of the United States. Your staff has indicated this limited personnel would have the capacity to collect $40 million and then only in the Southeastern region.

I do not know if you were here yesterday, but Mr. Fahey, who was the contract accountant assigned to investigate this whole matter, stated before the committee—I am paraphrasing now—that in effect it would be unfair to assume that the problem was restricted to the Southeast. The sampling indicated that the practices, whether it was excess crop payments or misuse of funds or whatever, probably could be found in all regions of the country.

He felt that if a proper job were to be done, indeed both the audit procedures and collection procedures should be applied right across the board in all regions of the country. I think I have correctly paraphrased his testimony.

I must confess that I agree. It may be that on a dollar volume in the last 2 years more money would have gone into the Southeast because of the particular disasters that occurred, but be that as it may, I would like your response to what is my suggestion, and I believe would be the suggestion of the committee, that if this is to be done, it should be done evenhandedly right across the board.

I might add that from the testimony given by Mr. Boucher as well as by Mr. Fahey I would imagine that the dollars that we are talking about could be astronomical, considerably more than the $40 million.

Mr. **Harper**. Mr. Chairman, I guess some of the background I bring to this situation is from the private sector. The concern of the private sector, which is essentially concerned with economic matters and which I think is fundamentally what we are concerned with when we are talking about debt collection, is how much payback are you going to get for your investment.

Essentially what we need to look at is where are the opportunities to recover the funds and what is the most effective way to recover those funds. I think it would be inappropriate for me to counter suggestions such as those made by Mr. Boucher, the Inspector General who is an outstanding professional.

I do not think I would be contradicting his point of view if I suggested that there is an array of tools and resources available in the area of debt collection. One principle is that you ought to find the big accounts. In the accounting profession, I think they call them the A accounts, those big items, that 20 percent of the items make up 80 percent of the inventory or 80 percent of the debts. Find those big items and go after them first whether it is in region IV or any other region of the country. Go after the big items first.

Another tool is, I think, that you can take a rote audit and say for every account we are going to do this. Or you can instead use different techniques such as inspections which may not be full audits.

I think that while it may do great things for the accounting profession to have a kind of rote audit of every single account across the country, I think former Comptroller General Staats—I talked with him many times about the prospect of a direct financial audit across the board—has always resisted that because he felt we had to be concerned about cost effectiveness and where was the best opportunity to employ those resources we have.

However, we can develop a profile. We know, for example, that we made so many loans on this crop. We can develop a profile of a crop. We can develop profiles of specific types of debtors. We can get a pretty good idea from those profiles where our greatest vulnerability is and target in there.

I agree that we should not look at just one region. I agree that the problem seems to be more widespread than that. The only thing I would urge is that we make the most effective possible use of those resources and we take advantage of the full range of tools available to our auditors and investigators.

Senator **Weicker**. To continue in response to your remarks, No. 1, the suggestion was made by those personnel who testified that we do go after the biggest loans first. However, again I have to point out when you talk about the payback, it is not strictly a matter of what you collect in terms of loans that have not been paid, but as the point was made very clearly yesterday, we want to send a message to those who are going to make loans in the future that the loans are going to be collected and that these abuses are not going to be tolerated.

I cannot, and nobody can, give you a dollar amount on that, but it is terribly important. From the testimony yesterday and from the staff's work in the field, believe me, most people feel that SBA just is not going to collect, that no matter how rough it gets, collections are not going to take place.

I think we want to establish that the money is going to be coming back to us that was paid out there, but also that in the future these abuses are not going to be tolerated. The only way you do that is to get on top of it. We can spout off all we want to here in this committee room, but unless there is somebody on the scene out there, it will not happen.

In your cost effectiveness business here, I want you to understand this prospective advantage that will accrue to us if we take this action.

Mr. **Harper**. If I may comment, Senator, I think you are absolutely right. That is one of the reasons I was delighted to see that you and the committee are holding this hearing because we do need to get the message across that the SBA is going to collect. It is not only the SBA but other Federal agencies as well.

I think it has been a scandal across Government as to what has happened on Federal debt collection. The SBA has unfortunately been, I think, one of the worst offenders in this area. I think the fact that you are holding these hearings, the fact that you are bringing people in from the field is going to help get that message across. We want to do everything we can to assist in that deterrence.

I recognize that it is not an absolute dollar tradeoff. Your point is exactly right and we wholeheartedly support it.

Senator WEICKER. My last question before I turn it over to Senator Dixon is that while I realize that my good friends in the Reagan administration want to save every possible penny, we are not going to do this job, as I indicated earlier, by you and I sitting here talking about it. You are going to have to get bodies in the field and bodies cost money. I feel that we will get much more back in terms of what is owed and prospectively if we get them there.

I really would hope, Mr. Harper, that in the personnel requests to resolve the most immediate problem; that is, the abuses that have already taken place, you will give consideration to some additional personnel who could be utilized on a broader basis than just in the Southeastern region.

Second, if cutbacks are going to take place, please—and I underline please—give consideration to what is already scheduled as a cutback in loan service personnel because these are the people who can stop the abuse up front. If you cut back on those people, the agency will be shorthanded and we are again going to have temporaries running around the place, and just sort of throwing the money out there so that they can accommodate as many people within a particular space of time.

What I am saying is I do not think we are going to save the kind of money that we want to save by cutbacks in that area. I urge you at OMB to take a long hard look both as to the temporaries to be assigned to clean up the old problem, and to take a very careful look to insure that we do not cut off one of our arms here in the sense of how the loans are to be handled in the future.

Mr. HARPER. Mr. Chairman, we will certainly take your admonition to heart. The $1 billion realization of debts to be collected is a very, very important objective. It is one that we at OMB take very seriously.

Senator WEICKER. We had testimony here yesterday that you might be able to pick up this $1 billion on this one program alone.

Mr. HARPER. I would be delighted if we could do it.

Senator WEICKER. That is the testimony we had. That is what the estimate is as to what is possibly out there. That is $1 billion on one program alone in SBA.

Mr. HARPER. I would hope that we have been conservative in saying we would collect $1 billion. The problem is that unfortunately there is no experience in terms of collections.

Senator WEICKER. Right.

Mr. HARPER. Until we get some experience, we were a little hesitant to jump too far out front.

There are a couple of points, if I may, to flush out the issue that you have raised. It is interesting that in the SBA only 25 percent of the personnel of the SBA work on loans and servicing loans. One of the things that undoubtedly would be something for us to contemplate is should there be some reallocation of resources within the

SBA. That is something I do not have any answer to this morning, but it is something I am sure we will be looking at along with Administrator Cardenas in the process of putting together our fiscal 1983 budget.

One of the other things that I found to be a very important technique in the private sector, where you have some of the same concerns you have here, was that you do not want to add permanent bodies to your staff to take care of temporary problems.

Second, you want to make sure that the incentives are right. For example, in the area of debt collection, you have that when you go with a private contractor because you can work out a contract, an arrangement with a private collection service that says you are going to get paid in relationship to what you produce. Of course the things that we would give a private collection service are not the easy ones because we would make a first cut at collecting the loans ourselves. Most people are responsible and they are going to pay their debts on time. That is not a big overhead item.

However, when you get into some of those tougher accounts when you actually have to go out, knock on the person's door, and follow up on them a number of times, that is where you need an incentive system. That kind of incentive system exists with the private collection services. That is why we feel that this is an important missing ingredient right now in SBA's ability to collect on some of those debts and why we urge Congress' acceptance of that legislation.

Senator WEICKER. Senator Dixon?

Senator DIXON. Thank you, Mr. Chairman.

Mr. Harper, I am delighted to see you here this morning. I might say preliminarily, with Mr. Boucher, the Inspector General who we heard yesterday, and Mr. Cardenas here, that I share the concerns of the Chair. I am glad to see your remarks concerning prosecution and the collection of these debts.

What concerns this committee so much is that there is no evidence that anything at all has been done to date. I take into account that it is a new administration. We are only 9 months into the first year of a new administration.

At the same time, some of the testimony we heard yesterday convinced at least me as a member of the committee—and I suggest it may have convinced other members—that there are a lot of things that can be done immediately.

I have two files here, Mr. Harper, which I would call to your attention, those concerning Mr. R. V. Segars of Oswego, S.C., and Mr. Thomas E. Davis of Blakely, Ga. I am not trying to pick on those two individuals. They happen to be people who were here yesterday.

My recollection of Mr. Segars is that he gave us a $2.7 million net worth when he obtained his loans. Under oath yesterday he reluctantly admitted to having at least $1 million net worth remaining at this point in time. I suspect it may be better than that. I would suggest that there is a man with assets so far as his obligations to our Federal Government are concerned.

In the case of Mr. Davis, we have testimony under oath that the man obtained duplicate loans with knowledge. He took two checks to two financial institutions, a PCA and another financial institution, paid his obligation to each with one of them, took the other checks back by endorsement, and put them in his own personal checking account.

I am a lawyer, Mr. Harper. These cases seem rather obvious to me. Therefore, I would only want to say to you, the Inspector General, Mr. Cardenas, and the Justice Department, which I hope has a representative here, that there seems to be some cases we might begin with.

I think the message the Chair and the committee wants to send out through you to the country is that it would be a very good thing if we could make some examples so that folks in this country would know that we are concerned about their dollars here.

The Internal Revenue Service has made an impression on people in the country. Most people are pretty scared and pay their taxes. I would suggest that SBA might do some things in that regard as well.

I wonder what your comment might be to that general observation.

Mr. HARPER. I have to say that the first time I became aware of this was earlier this year when we became involved in this overall project of debt collection. I had the opportunity to spend some time with SBA's Inspector General Paul Boucher, who is indeed an outstanding professional. We are delighted that he is leading up that team.

He told me some of the stories along the lines that you have heard right here. Frankly, I was shocked and outraged at what he had to say and I asked if we had prosecuted these people. Are they in jail or have they made restitution?

He said that unfortunately in many cases, the way the law is written, the way the regulations have been created and interpreted in the past by SBA and the Department of Agriculture, there was nothing we could do about it. They did not violate the law.

Thus, one of the things, I know, that has been a high priority of the Inspector General and the Administrator of SBA is to get back into these problems and to get these regulations changed so that there is a screening by the Department of Agriculture and by SBA to make sure that we do not have people collecting more than one check for the same disaster and then using those funds.

To me, I kind of doubt that this is what the Congress intended when they passed either the SBA legislation or the Agriculture Department legislation allowing for these loans to be made.

Senator DIXON. I hear what you are saying. We heard the same testimony yesterday. As I used the expression yesterday, I think it is a strong indictment of the Department that things are in such shape that there is a view in Justice and everywhere else that nothing can be done about the things that have occurred in the past.

However, I would feel compelled to persist in saying that Senator Rudman, Senator Gorton, the Chair, others, and we here yesterday felt that some of the cases were better cases than others including Justice, perceived them to be. As a person with some background in that area of law, I have to say that at least one case yesterday seemed fundamentally sound to me and a case one could make.

While I do not want to pick on anybody, I want to again say that evaluations of all of the things we have at hand seem to me to give us some opportunities to make an example that will send a message to the country regarding obligations owed the Government and regarding what I consider to be criminal misbehavior in some cases.

I do not want to be a person who is critical of those at the table because you folks are new here. What has occurred in the past is not your problem, except to the extent that now you accept your responsibilities in the matter. I would suggest that there are some things here that could be done.

Mr. **Harper**. I think you are right. I hope that one of the benefits of securing the designation of SBA attorneys as special U.S. attorneys will be that we will be able to initiate some prosecutions that otherwise might not be possible.

As you know, there are many demands on the time of a U.S. attorney in terms of many opportunities to prosecute. It is not always clear what criteria the U.S. attorneys use. That is why with these special designations I am hopeful that we will see more prosecutions in the SBA loan area.

I think one other message that I hope this kind of hearing gives—it is one that I try to send out—is that here we are relatively new in this administration, and yet I already find, not necessarily in SBA but in other areas, where you will say something critical of what an agency has done. Then you will hear something back to the effect of do not say anything critical about what we did last year, 2 years ago, 5 years ago.

We cannot allow ourselves to be co-opted like that. We have to realize that there was a mistake in the past. It may be our mistake. It may be somebody else's mistake, but we have a responsibility to correct the mistake, to be critical of the mistake, and to move ahead.

Frankly, that is the way I think Administrator Cardenas sees this, that he is not afraid to be critical of what has been done in the past. I am sure that probably some time in the future he will find something to be critical of in his own performance. I think he is that kind of an objective individual. I think it is an important message for us to get across back throughout the bureaucracy and one that we are certainly trying to do.

Senator **Dixon**. I thank you, Mr. Harper.

Mr. **Harper**. Thank you, Senator.

Senator **Weicker**. First of all, let me say that I concur 100 percent with your evaluation of the Administrator. Mr. Cardenas has been before this committee many times in the past. As we have gone over the programs of SBA, he has not hesitated to point out where the weaknesses are. As you say, I have no doubt, even if it occurs under his administration, he will do the same thing. He has been right on top of the table on all of these matters. I have great confidence in him.

We contacted the SBA yesterday after the hearings to find out what the cost would be as to a collection effort on a nationwide basis. The figures that were given to us were a cost figure of $6 million and the utilization of 270 temporary employees for collection purposes.

It is my understanding that these funds could be transferred from the disaster loan fund itself. I throw this out on the table as something to be considered by OMB and by the Administrator. Certainly any assistance that is required by this committee or the Appropriations Committee of which I sit as the chairman will get a receptive ear.

I think this is possible to do. It would seem to me to be a good example not only within the SBA, but also for the other agencies of the Government, were it done.

Point No. 2 is that one of the difficulties we would have around the country, beating down on everybody's head who is delinquent, is that, based upon the other testimony that came before our committee yesterday, the fault as often as not lay with SBA. I have no doubt from the testimony that was given that it was SBA that was encouraging many of the wrongful practices in loan applications themselves.

It is not just a matter of a bunch of American citizens out there who did the wrong thing. The Government itself did the wrong thing. Because of that it requires a little bit of commonsense, I think, when it comes to collection time.

Mr. Harper, although I agree with much of what you say, I have tactfully and purposely not commented on the administration's Debt Collection Act because there are certain aspects of it; that is, the use of the IRS, that I would have severe exception to, but that is not the purpose of this hearing.

So many times hearings are held and that is it. The law has pretty much been changed by virtue of the change in the authorizing legislation and by virtue of what was achieved through the reconciliation bill. I want to say that to the administration's credit—they wanted to eliminate this program entirely from SBA—we did achieve a compromise within the Appropriations Committee.

Had I had this hearing before the reconciliation bill, I would have hung even tougher on that issue on behalf of the administration. I think they are right. SBA should not be in this at all. I think we have worked out a formula where for all practical intents and purposes all these loans are going to go through Farmers Home Administration. There is no doubt in my mind that that is where it ought to be.

Be that as it may, the law has changed so it probably will not happen again. The one thing that can come forth from this hearing is that we collect this money or we nail those people who really abused the law. I do want to see that achieved.

Therefore, as to my recommendation here to you as to what is required to do the job nationwide, I would really like to have some response from you and the Administrator within the next several weeks as to what it is we are going to do in that regard because that is totally within your power, the Administrator's power, and my power to do immediately.

Thank you, Mr. Harper, for appearing today.

Mr. HARPER. Thank you, Mr. Chairman.

[The prepared statement of Mr. Harper follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

STATEMENT OF EDWIN L. HARPER
DEPUTY DIRECTOR
OFFICE OF MANAGEMENT AND BUDGET
BEFORE THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE
ON SBA FARM DISASTER LOAN PROGRAM
SEPTEMBER 10, 1981

Mr. Chairman and Members of the Committee,

I appreciate the opportunity to be here today to discuss the Administration's efforts to improve debt collection in the Federal Government, and to comment specifically on the SBA Disaster Loan Programs for farmers and homeowners.

Debt collection is more than an academic or theoretical concern at OMB. Failure to achieve our debt collection target in FY 82 would widen the budget gap by $1 billion. Achieving that target depends upon the Congress passing The Debt Collection Act of 1981 (S.1249).

THE PROBLEM

I am sure that you are already aware of recent studies by the General Accounting Office and our own Debt Collection Project that reveal serious problems in Federal credit management and debt collection.

For example, our studies of fiscal year 1979 receivables of $175 billion revealed that:

- More than $25 billion of the $175 billion debt was delinquent or in default;
- An additional $8.4 billion was in some form of rescheduled or stretched out status because of borrowers' inability to pay;
- Over $1 billion in bad debts were written-off in fiscal year 1979 alone; and
- Write-offs in future years were estimated to total over $6.3 billion.

Further, data reported to the Department of the Treasury showed total outstanding debt owed to the Federal Government of $190.8 billion on September 30, 1980. This represents a 9% increase over fiscal year 1979.

The problems which have given rise to the enormous amount of overdue debts are extensive, and exist throughout the entire credit cycle - from the initial screening of debtors to ultimate collection. One of the overriding problems is that the information systems that we have today cannot provide accurate and timely information on the amount of debt owed, the amount due, and the condition of the debt in terms of delinquencies and defaults. To arrive at the numbers for fiscal 1979 required a massive one time effort by OMB and the executive agencies.

The problems that we are trying to solve involve: (1) insufficient personnel and equipment resources allocated to deal with the debt workload; (2) a litigation process that impedes efficient enforcement of debt collection and (3) current Federal laws and regulations that inhibit the Government from taking advantage of collection tools commonly used in the private sector.

EXECUTIVE BRANCH ACTIONS

President Reagan has recognized the seriousness of this situation. On April 23, he directed Executive Branch departments and agencies to implement an aggressive debt collection program. The President stated:

> "Allowing uncollected debt to grow increases the cost of Government and adds to the inflation that hurts every one of us. We must make it clear that debts owed to the Federal Government must be repaid.....It is not right that responsible honest citizens should suffer because of those who do not honor their obligations or pay their taxes."

We are now working with the agencies to carry out the President's directive. Each agency has given us a preliminary action plan that describes major debt collection problems in the agency, specific steps to be taken to resolve the problems, and a timetable for each action item. We are now reviewing these plans. Once they are finalized, we will closely monitor agency progress in implementing improvements. I can assure you that this Administration is fully committed to improving the debt collection process in the agencies.

DEBT COLLECTION LEGISLATION

We are certain that administrative actions alone will not solve the Government's debt collection problems.

Legislative actions are needed to make available essential tools and techniques commonly used in the private sector and to provide for increased efficiency and effectiveness in the way the Government goes about granting credit and servicing and collecting debt.

One step this Administration has taken toward addressing these legislative needs is to fully support the Debt Collection Act of 1981 (S.1249) which is co-sponsored by 33 Senators, including six members of this Committee. Mr. Chairman, the legislative remedies in S.1249 will:

- o allow referral of credit information on delinquent debtors to credit bureaus;
- o require credit applicants to furnish their social security numbers for credit management purposes;
- o provide for the offset of delinquent debts owed the Government by Federal employees against their salaries;

- make it a Federal offense to assault a Federal employee during the course of his official duties in collecting amounts due the Government;
- screen applicants seeking either Government direct or guaranteed credit with the Internal Revenue Service to assure that credit is not extended inadvertently to those who have failed to pay their taxes;
- allow agencies to redisclose delinquent debtor addresses obtained from the Internal Revenue Service to private sector contractors pursuing collection of debts;
- raise the interest rate on delinquent taxes due the Internal Revenue Service from 90 to 100 percent of the prime rate, with annual adjustments;
- require the assessment of interest on non-tax debts due the Government at the Treasury's Tax and Loan Account Investment Rate, additional charges to provide for recovery of the costs incurred by the Government to collect delinquent debts, and, when appropriate, a penalty charge on debts that are more than 90 days past due;
- provide that the six year statute of limitations does not prevent the administrative offset of delinquent debts owed the Government against future payments, benefits, or refunds due delinquent debtors;

- allow the courts more latitude in the use of special appointments to serve summonses in Federal debt cases when U.S. Marshals are not available for timely serving; and
- allow Federal agencies to contract for collection services in recovering debts owed the United States. (Does not include SBA.)

While S.1249 is not the subject of the hearing today, it is essential to our overall debt collection effort. I, therefore, would like to encourage the support of you and all the members of the Committee for that bill.

SBA DISASTER LOAN PROGRAMS

I described the Federal Government's debt collection efforts as being a "serious problem." SBA has had an especially serious problem in Region IV. 8500 loans representing almost one quarter of a billion dollars are in deep trouble in the Region. This region has 1/3 of all of SBA's troubled loans.

The work of Mike Cardenas, the SBA Administrator, and his Inspector General, Paul Boucher, deserve credit for exposing this problem along with this committee's own staff.

Mr. Chairman, management problems I have outlined are not unique to SBA or it's Disaster Loan Programs. Similar problems exist, unfortunately, in many federal loan programs. This Administration is concerned and, as I just indicated, is taking steps to see that the problems are solved. It is the intent of the Administration to work with the Congress to strengthen the management of all SBA programs, including those that make Disaster Loans.

Along these lines, I would like to review for you some of the steps OMB has taken already and others that will be taken in the upcoming months to support Administrator Cardenas' attack on the debt collection disaster in Region IV. We have:

- o Approved 99 temporary positions for the SBA to mount a specially designed effort in its Atlanta region to collect disaster home loans and farm loans. This action will help solve the immediate problem in that region where 6,000 farm loans and 2,500 disaster home loans are in trouble.
- o Encourage the SBA to seek the administrative offset of delinquent debts against future payments, benefits, or refunds due the delinquent debtors from SBA or any other Federal agency. The fundamental question is whether someone who is delinquent on a debt owed one agency should be allowed to continue to receive, unimpeded, payments from other Federal programs.

- Assist the SBA in working with the Justice Department to investigate and prosecute those debtors who fraudulently obtained duplicate federal loans as well as those debtors who have refused to repay legally obtained loans. This would possibly include expanding the number of SBA attorneys who are designated Special Assistant U.S. Attorneys by the Justice Department in order to provide more resources to handle these cases expeditiously.
- Encourage the SBA Inspector General to increase, either by using his authority to contract with private firms or by redirecting work internally, the amount of resources available to audit the SBA farm loans and disaster home loans. Audits are particularly effective in identifying those loans involving duplicate benefits, misuse of proceeds or excess payments.

As part of the upcoming FY 1983 Budget Review, OMB will review SBA's projected debt collection efforts and resources for FY 1982 and FY 1983 and, with SBA, propose additional legislation as necessary. This will include an evaluation of the potential use of resources in private sector institutions that are experienced in making, servicing and collecting loans and the possible reallocation of personnel resources within SBA.

CONCLUSION

Mr. Chairman, the degree of interest you, the members of your committee, and other members of Congress are showing in our debt collection efforts is most helpful. By continuing to work together, we will bring the Federal Government's credit programs under control and ensure that monies are collected when due from those debtors with the ability to pay.

Mr. Chairman, this concludes my prepared statement. I will be happy to answer any questions you may have.

Senator **WEICKER**. The next witness to appear before the committee is Mr. George Jett, the General Counsel of the Federal Emergency Management Agency.

Mr. Jett, please take a seat and present your testimony to the committee in any way that would be most appropriate. Your statement in its entirety will be included in the record following your presentation.

STATEMENT OF GEORGE W. JETT, GENERAL COUNSEL, FEDERAL EMERGENCY MANAGEMENT AGENCY, ACCOMPANIED BY RICHARD SANDERSON, DIRECTOR, FEDERAL RESPONSE COORDINATION

Mr. **JETT**. Thank you, Senator Weicker.

In the interests of time, I will summarize my statement quickly, but I ask that it be included in the record as you indicated.

The Federal Emergency Management Agency has important disaster assistance authorities which I would briefly outline to the committee.

One, the President asked us to provide oversight and coordination for disaster assistance programs of the other Federal agencies. He directed that as a part of the Reorganization Plan No. 3 of 1978 when FEMA was established. He issued an Executive Order, No. 12148, which charged FEMA with oversight and coordination of other Federal disaster planning and assistance programs.

He also charged us with the management responsibility for the Disaster Relief Act of 1974. That act has an important planning provision. We provide States grants to do emergency planning and to develop a planning system in each State.

More importantly, we provide disaster assistance and response when major disasters or emergencies occur. This would occur in situations where a Governor finds that the resources of the State are exceeded by the scope and nature of the disaster. Where he requires large scale Federal assistance to supplement State and local efforts, he would request a disaster or emergency declaration from the President. When a Presidental declaration occurs, FEMA generally becomes the lead Federal official for coordinating and managing the overall Federal response to the disaster.

Those are authorities that our agency has which I think have a bearing on your committee's hearings today.

I would like to briefly just point out that my statement outlines some steps we are taking to avoid duplication and unwarranted payments when a disaster occurs.

The first step we do when a Governor requests disaster assistance is to contact other Federal agencies and find out which of their programs can be brought to bear to meet the circumstances confronting the victims. In many cases, Federal assistance can be provided by other departments and agencies which is ample to meet the needs of the community or the needs of the victims. That would be an ongoing process where we would be in touch with the Corps of Engineers, the SBA, the Department of Agriculture, the Federal Highway Administration, and several other agencies that may be involved.

If a disaster is declared, we set up one-stop centers where we bring all the Federal agencies into one place. There disaster victims apply for the assistance they need under the various Federal programs that have been determined to be applicable. We are working on a system which would have all the agencies review the application that the disaster victim makes for Federal assistance so that we would have a situation where a combined application would be made.

The victim would come into the one-stop center, make an application for assistance, and several Federal program officials there at the center would look at which parts of their programs might be applied to the circumstances confronting the individual. In that respect, we would have a good opportunity to see to it that one agency was not providing assistance which was duplicating the assistance of another agency.

We have also taken some steps to recover Federal disaster assistance expenditures where we find there are circumstances that might indicate that some party is responsible for causing or aggravating a declared disaster. When we believe there may be circumstances where neglect or at least some fault is involved, we enter into a Federal-State agreement with the State which contains a provision allowing the Federal Government, at a later time, to intercede in litigation against some party possibly at fault.

We actually are involved in, or monitoring, some litigation in those circumstances, particularly in Love Canal where an emergency was declared several years ago and in the State of Kentucky where a disaster was recently declared on a sewage explosion that may be the responsibility of some other party.

We have also recommended new legislation as an amendment to the Disaster Relief Act to authorize the Attorney General to sue to collect disaster assistance found to be excessive.

Those are steps we have taken to try to eliminate duplications and excess as we find them in the authorities we have.

On the SBA issue that is before you, I appreciate the opportunity to comment on the issues. I did furnish you a letter of August 14 with, frankly, my very brief assessment of the issues that were reported in Mr. Boucher's IG report.

I hope that I outlined some approaches that might be taken by SBA to at least consider the possibility of recovering duplications if they can determine that a debt or claim is owed the Government. We have had some communications with SBA already and we hope that that liaison will be more active and continue in the next few months.

As I understand it, the question really gets to one of, if there is a duplication of loans, is it in fact a debt or a claim. If it is not, there will be some limitations to the possibilities of recovery.

The other question related to whether FEMA could delegate a certain authority it has to SBA which might assist them in recovery. In that respect, at this point in time I do not see that the delegation would be worthwhile, principally because the delegation seems to go to assistance provided under the terms of the Disaster Relief Act that might be found to be excessive and not to authority or assistance provided under different legislation. Of course the SBA loans are provided under the SBA Act. I do not think the recovery there under section 315 of our act would apply in those circumstances.

However, we are working with SBA to explore the possibility that that may form a basis for a claim. If that is the case, then we will of course immediately issue a delegation to SBA to have that process proceed.

I believe that summarizes my statement, Senator. I ask that my letter of the 14th of August be included in the record if that is permissible.

Senator **Weicker**. It certainly will be included.

[Subsequent information was received and follows:]

FEDERAL EMERGENCY MANAGEMENT AGENCY
Washington, D.C. 20472

Honorable Lowell P. Weicker, Jr.
Chairman
Select Committee on Small Business
United States Senate
Washington, D.C. 20510

[illegible] 4 [illegible]

Dear Mr. Chairman:

This is in response to your letter of July 21, 1981, to Louis O. Giuffrida, Director of the Federal Emergency Management Agency. In your letter, you requested our views on the circumstances under which the Government can institute proceedings to collect excess or duplicate disaster loan payments and whether the Small Business Administration (SBA) requires a delegation of authority from FEMA to recover payments for these loans. As General Counsel of FEMA, I am responding on Mr. Giuffrida's behalf.

In my view, the Federal Government, acting through its departments and agencies, has a clear legal right and an obligation to take action to collect any debt which is owed. I believe this authority and duty stems from the statutory responsibility of agencies to manage and administer Federal programs, whether or not that agency's specific legislative functions authorize either the recovery of funds expended by error, or otherwise provide for the collection of obligations and debts owed the Government. Several important Federal cases support this finding, including Mount Sinai Hospital of Greater Miami, Inc. v. Weinberger, 517 F.2d 329 (1975); U.S. v. Barlow, 132 U.S. 271 (1889); and Wilson Clinic & Hospital v. Blue Cross of South Carolina, 494 F.2d 50 (1974).

On this basis, I am of the opinion that the Federal agencies, including SBA, are authorized to pursue efforts to recover duplicative disaster loan payments for loans issued under their applicable statutory authorities. Additionally, I would point out that the Federal Claims Collection Act and the False Claims Act contain provisions by which SBA may initiate steps for the collection and recovery of excess or duplicative loan payments under its disaster loan programs.

As to the requirement for a delegation of authority from FEMA to SBA to collect for duplicative disaster loans, this issue was recently addressed in the Semi-Annual Report of the

Inspector General, SBA, covering the period October 1, 1980 to March 31, 1981. In this report, the Inspector General indicated that approximately $1 million in duplicate farm disaster loans issued under SBA's authorities would not be recoverable because FEMA had not issued a delegation of authority under Executive Order 12148 and the Disaster Relief Act of 1974 to SBA to seek collection from the loan recipients. Prior to receiving the Inspector General's final report, we were unaware of SBA's views on this issue and we have received no request for a delegation instrument to institute collection action.

Based on the legal analysis outlined above and on a review of the provisions of Executive Order 12148 and the Disaster Relief Act, I am of the view that SBA may take action to recover these loans without delegation of authority by this agency. The provisions of the Disaster Relief Act which were delegated to the Director, FEMA, by Executive Order 12148 and which address recovery of duplicate disaster benefits are contained in sections 315(a) and 315(c) of the Act. Those provisions, in my opinion, pertain to the authority of the Director, FEMA, to assure that there is no duplication of benefits under programs providing assistance under the circumstances of a "major disaster" declared by the President under the Disaster Relief Act and are not restrictive of any authorities of Federal agencies to seek recovery for duplicative or excessive payments for disaster losses authorized by other statutory authority. Additionally, I find several provisions in the Small Business Act - particularly at sections 636, 645 and 647 - as well as sections in SBA's regulations at 13 CFR 123, which address policies and procedures with respect to duplication of benefits for the disaster loans.

Consistent with the President's policies, the FEMA Director is now instituting new procedures to enhance our prevention of wasteful or fraudulent actions and to recover amounts owed the Government from past activities. While we do not now believe that a delegation from FEMA to SBA is required, we are most anxious to resolve this issue to assure that proper recovery actions can be taken by that agency. We have already held an initial meeting with officials from SBA to review their position and to explain our views and are scheduling additional meetings to resolve these questions. If it is finally determined that a delegation by FEMA to SBA is necessary for recovery action on these or other duplicative disaster loans outstanding, one will be immediately prepared for issuance by the FEMA Director.

I will keep you advised of our progress in resolving these issues.

Sincerely,

Signed
George Jett
General Counsel

Senator **Weicker**. The reason why you heard me talking to counsel here is I have a series of questions I did not quite understand. Maybe it will help clarify the situation.

In effect, the first question would have referred to the August 14 letter where you responded that the SBA has the authority to collect these loans. Then I was going to ask you this question: Mr. Jett, I have a memorandum dated August 27, 1980, written by Robert Weber, the associate general counsel for SBA region IV. This memorandum was addressed to the central office general counsel.

The memorandum states that:

> FEMA has not and will not be delegating authority to SBA to accelerate indebtedness arising from SBA loans which duplicate benefits borrowers have received from the Farmers Home Administration. As we cannot expect a redelegation under 42 U.S.C. 5155, the agency does not have the authority to call loans unless, as you have noted, in the specified event of default and loan documentation can be established.

I gather that this is not the policy. August 27, 1980, would be the previous administration. I gather this is not the case either as practiced by SBA or as instructed by FEMA. Would that be correct?

It seems to me my staff might have been setting up a strawman here which really did not apply to the real situation that we are talking about, or does it apply?

Mr. **Jett**. It might apply. We were not aware that SBA thought there might be a possibility that duplications like this might be collectable under our act. As I say, we have reviewed that and we do not think they are collectable under the act, but we want to explore that further with SBA.

We had not been asked to make a delegation, and, frankly, had not considered that to the best of my knowledge. I have not seen the regional memorandum from the regional counsel at SBA.

The question of whether SBA otherwise has authorities to collect for duplications is indicated in my August 14 paper. I did cite several cases where Federal agencies have recovered even though their statute provided no express basis for recovering. They recover on a basis that the actions that had occurred in one way or another formed a claim or a debt owed the Government, and notwithstanding the fact that their legislation did not have an express provision, they sought recovery and were successful.

I would suggest that those cases be considered. Also, I made note that the Claims Collection Act and the False Claims Act, depending on the circumstances of these loans, may form a basis for collection. However, at least at this time, my view is that a delegation under our authority would not be effective for recoveries because the assistance, in terms of the loans, was not extended under the authorities of the Disaster Relief Act, but the SBA Act.

Senator **Weicker**. Thank you very much.

Mr. **Jett**. Thank you.

[The prepared statement of Mr. Jett follows:]

STATEMENT OF
GEORGE W. JETT
GENERAL COUNSEL
FEDERAL EMERGENCY MANAGEMENT AGENCY
before the
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE
September 10, 1981

Thank you for the opportunity to testify before your Committee this morning.

I understand that the Committee's hearings are to review issues concerning better ways to avoid duplicative and excessive Federal disaster expenditures, and the collection and recovery of such expenditures when discovered, with specific attention on disaster loan programs of the Small Business Administration. These issues are of particular interest to the Federal Emergency Management Agency (FEMA) in our role as overall Federal coordinator of emergency planning and response programs on behalf of the President.

FEMA was established under Reorganization Plan No. 3 of 1978, as a joint effort by the Congress and President to create an improved and more efficient organization for implementing Federal activities for emergency planning, mitigation, response and recovery. Under the reorganization and Executive Orders 12127 and 12148, FEMA manages key federal emergency programs authorized by Congress including major disaster assistance, civil defense and flood insurance. Of equal importance, we coordinate and provide overall policy for the emergency planning and response functions carried out by other Federal departments and agencies. Our coordination and policy-making responsibilities include preparedness and response activities ranging from national security threats against the United States, including enemy attack, to natural and man-made disasters and emergencies. We have active liaison with nearly three dozen agencies in setting emergency missions and overseeing response capabilities.

The subject of today's hearing relates most particularly to FEMA's authorities under the Disaster Relief Act of 1974 and Executive Order 12148 to plan for and coordinate federal response to major disasters and emergencies. The Disaster Relief Program is designed to supplement the efforts and available resources of State and local governments and voluntary relief organizations when a major catastrophe strikes. The President's declaration of a "major disaster" or an "emergency" indicates that State and local capabilities have been exceeded by the scale of the crisis and authorizes Federal assistance under the Act. In many cases, the President's action triggers a series of federal programs which can respond to the incident. This declaration by the President can come only after the Governor requests such a declaration.

Assistance authorized in the Disaster Relief Act for individuals includes: temporary housing for disaster victims; disaster unemployment assistance and job placement assistance legal services to low income individuals, crisis counselling and individual and family grants of up to $5000.00 to meet disaster-related necessary expenses or serious needs of those adversely affected by a major disaster.

Assistance to State and local governments may include: clearance of debris on public or private lands or waters; emergency protective measures for the preservation of life and property; emergency transportation and communications; fire suppression; repair or replacement of roads, streets and bridges, water control facilities, public buildings, or other public facilities and community disaster loans.

In managing these authorities, FEMA has taken several important steps designed to avoid duplication and excessive disaster assistance commitments by Federal agencies, and significantly, to recover payments when later found to be inappropriate or unwarranted.

When a catastrophe strikes, FEMA immediately initiates actions to assess the extent of damages and potential Federal programs that may be able to respond. In many cases, the situation is such that Federal disaster assistance programs, such as the SBA disaster loan program, can provide adequate and effective assistance without the need for a Governor's request to the President and a Presidential declaration of major disaster or emergency under the Disaster Relief Act. About one-half of the Governors' requests for disaster declarations by the President are turned down, many on the basis that other Federal programs available for the emergency are fully sufficient.

When a disaster or emergency is declared by the President, we take steps to assure that duplication of benefits is avoided. For example, we do not, as a rule, provide disaster assistance funding under the Disaster Relief Act for work which other Federal agencies may fund under their own statutory authorities. When another Federal agency has authority and the necessary funds available to respond to personal needs and to restore property or facilities damaged or destroyed by a disaster, that agency's funding authority is used instead of the President's Disaster Relief Fund. An example of this is where, in flooding situations, the Corps of Engineers may be called on to use its discretionary authority for flood emergency preparation; flood fighting and rescue operations and emergency repair and restoration of flood control works. Likewise, Federal Highway Administration may provide assistance for the repair or reconstruction of highways on the Federal-aid systems, forest highways, forest development roads and trails, park roads and trails, and certain Indian reservation roads damaged by a disaster.

As to SBA, FEMA maintains a very close liaison with that agency both as to planning for response to disasters and in the actual response situation. When a disaster occurs, we review with SBA the programs it will activate under its own statutory authority and assess the extent to which this form of assistance effectively addresses the disaster conditions and recovery for private citizens and State and local governments. On the disaster scene, SBA and FEMA often work desk-to-desk in the disaster centers to better service victims and assure that program applications are consistent and not wasteful.

As an additional step in reducing duplications and streamlining disaster assistance to victims, FEMA has been working for some time to develop a new assistance application and verification process. Basically, the procedure would combine the applications of FEMA's Individiaul and Family Grant Programs, the SBA's Physical Disaster Loan Program, and the Temporary Housing Program into one simplified action. It also would combine the collection and verification of the separate information functions for these programs into one operation. The goals are to minimize confusion for the disaster victims by giving him the best assistance package possible and enable the Federal Government to better coordinate the prevention of duplication of benefits between the programs involved in disaster relief. We have tested the process several times and are now studying ways to improve it and eliminate problems.

The GAO mentioned this process in their report on the 1978 Massachusetts Blizzard, a Presidentially-declared major disaster, stating that this procedure if effectively implemented could reduce the incidence of duplication in other disasters if there is adequate coordination among those agencies providing assistance.

FEMA is also involved in efforts to recover Federal disaster assistance expenditures on several important fronts.

Our current procedures provide that after the disaster work has been completed, payments from the President's Disaster Fund are audited to see if funds were utilized for the appropriate work and whether funds were used from other sources. If the audit reveals duplication of expenditures or benefits, there will be a recommendation to take appropriate action to recover the funds. The applicant also must certify that he did not apply for or receive adequate assistance from any other source. Necessarily, the providing of false information subjects the applicant to criminal and civil liability under various sections of the U. S. Code.

In addition, in several recent major disaster declarations, we have included providions in the Federal-State agreements with respect to specific recovery of Federal disaster expenditures. These are used in circumstances where the damages and destruction potentially were caused or aggrevated by the negligence or improper actions of some party -- including possibly a third party. Litigation is now ongoing which may well restore significant amounts of federal funds in five recent disaster situations.

Also consistent with these steps, FEMA has forwarded legislation — introduced as S. 1216 in the Senate and H.R. 3699 in the House -- to amend the Disaster Relief Act of 1974 by adding a new section 319. Section 319 would expressly give the Attorney General of the United States authority to institute actions against parties where they caused or contributed to the events resulting in a Presidential declaration of emergency or major disaster. The party could be liable to the United States for the full amount of Federal expenditures made to alleviate the suffering or damages attributable to the actions of the parties.

Presently, the Inspector General of FEMA is chairing an inter-agency Inspector General project involving the review of Federal disaster assistance programs. SBA is participating in this study. The project is being coordinated by the President's Council on Integrity and Efficiency and is charged with identifying any areas of duplication that may exist in disaster assistance programs and recommending any needed corrective actions. The various types of disaster assistance have been reviewed and areas having potential for overlap or duplication have been identified. These areas involve programs administered by FEMA, SBA, the Department of Agriculture and some volunteer organizations.

In closing, I want to briefly address issues recently brought to the Committee's attention in the SBA Inspector General's report on that agency's authority to initiate actions to recover reported excess or duplicate disaster farm loans. I have corresponded with the Committee on this issue by letter of August 14, 1981, and ask that that letter be included in the Record.

To summarize our views, FEMA believes there are several avenues worth exploring in terms of potential actions to be taken to recover these expenditures. I understand that SBA has attempted recovery steps with the Department of Justice and, thus far, has found no clear remedy within their statutes or in other provisions of the U. S. Code.

At this time, we remain of the opinion that a delegation by FEMA under Executive Order 12148 and Section 315 of the Disaster Relief Act of 1974 will not be of assistance to SBA in this particular recovery effort. However, as my letter indicates, we have initiated discussions with SBA on this and other potential recovery actions to assure that all possible avenues are fully explored and resolved.

Mr. Chairman, I would be pleased to answer any questions the Committee might have on my testimony.

Senator **Weicker**. As our last witness we have the man who is going to resolve everything. Mr. Administrator, please come and sit down.

Administrator Cardenas is with us. Please proceed in any way you deem most appropriate.

STATEMENT OF HON. MICHAEL CARDENAS, ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION, ACCOMPANIED BY CHARLES R. HERTZBERG, DIRECTOR, OFFICE OF BUSINESS LOANS: EARL L. CHAMBERS, DIRECTOR, OFFICE OF PORTFOLIO MANAGEMENT; AND WILEY S. MESSICK, DEPUTY REGIONAL ADMINISTRATOR, REGION IV

Mr. **Cardenas**. Mr. Chairman, Senator, and staff of the committee, I have with me this morning on my left Mr. Charles Hertzberg in case there are any further questions, and, as requested, Mr. Wiley Messick, deputy regional administrator of region IV.

I would like to discuss with you the Small Business Administration's new program to bring under control the various problems in agricultural disaster lending that previous witnesses have described.

As we know, in the spring of 1977, when the extent of the drought in the South and Midwest became apparent, SBA opened the disaster loan program to farmers. It was in this setting, with no prior experience, that SBA began its disaster farm lending program.

There was much for the agency to learn, but little time in which to learn it, since the program came into being in the midst of a serious drought. All the while that SBA was developing the program, there was intense pressure to get the money flowing. And this the agency did. The program level increased tenfold, from $200 million a year to over $2 billion a year.

However, my remarks should not in any way be construed as an excuse or a justification for any errors or any wrongdoing that occurred during the implementation of this program. There is no doubt that many errors were made. The SBA audit reports and the committee staff findings have detailed areas where excess payments and duplicate loans may have been made. The excesses detailed by the various reports largely refer to matters that took place early in the program's existence. They involve mainly loans made in connection with the widespread 1977 drought disaster.

Since that time SBA has made many changes to correct various problems. As SBA has gained experience, its regulations have been changed to reflect the agency's understanding of the economics of farming. Particularly, SBA has changed its methods for identifying the amount of losses, setting terms for disbursement, drawing loan terms and conditions, and insuring that duplicate assistance is not forthcoming. Finally, Public Law 96-302 has put the responsibility for providing farm disaster assistance back in the Department of Agriculture, where it belongs.

Regarding the current status of the farm loan portfolio, as of July 31, 1981, there were 74,891 farm loans on our books. Recognizing that these loans call for once-a-year annual payments, it is significant to point out that over 87 percent of those loans are paid to date and are considered current. Geographically, the majority of these loans are in the Midwest, the Southwest, and the Southeast, as might be expected. These are the parts of the country which have sustained varying degrees of severe weather problems during the past 5 years. Ninety-seven percent of Kansas City's 20,883 loans are current, while 89 percent of the Dallas region's 20,682 loans are paid to date. The Atlanta region, which contains eight Southeastern States and which has been victimized more heavily by adverse weather problems in the 5-year period, has 23,874 loans and a current rate of 76 percent. This, incidentally, is an improvement over June 30 figures which stood at 74 percent.

The troubled portion of the total farm loan portfolio, the other 13 percent, may be divided into three parts. The first is that group upon which we have made conscious credit decisions to defer this year's payment until after harvest time this fall. This represents 6.28 percent of the numbers.

The next group, 4.61 percent of the total, are those on which servicing actions and face-to-face decisions have not been finalized and that are at least 60 days past due. In actual numbers, the figure is 3,455, of which 2,272 are in the Southeast.

The final category, less than 1 percent, are classified as liquidation cases. While SBA's efforts are primarily directed at saving every possible loan so that it may ultimately pay out, most liquidation cases result by virtue of other lenders ahead of SBA in lien positions instituting foreclosure actions over which we have little control. After 5 years and over $3 billion in disbursed loans, we have sustained $14.8 million in charged-off losses. This very low rate should not, however, mask the fact that without a concerted effort to provide additional human resources to address critical current problems, such as those in the Southeast, the portfolio problems can magnify very rapidly.

The servicing, collection, and liquidation activities related to farm loan, regular business loan, and extensive disaster home loan portfolios are handled by the same staffs. As each year passed, the size of the portfolio to be maintained has increased.

Relatively speaking, the Midwest has presented the fewest problems, which we can attribute to generally better weather conditions. This segment of the farm portfolio demonstrates, in our opinion, that farmers, like other borrowers, do pay when they have had a successful season.

On the other hand, the Southeast, having had worse luck with the weather, reflects a condition in which farmer-borrowers want to meet their obligations but are having difficulties. This set of circumstances triggers the case-by-case problem-solving difficulties requiring that reasonable solutions be worked out. Because of the general nature of the financial cycle in farm operations, the problems come in waves. Our efforts to meet these onslaughts fill the calendar from February through August with thousands of individual decisions to subordinate, to defer, to mount collection "outreach" projects, and to carefully decide which cases have reached the end of the line.

Professionally trained loan officers with counsel and assistance from our lawyers, plus a few clerk typists, combine their time and talents to achieve the necessary results. We have learned from experience, and we have improved our abilities to recognize and react to the demands of collections and delinquencies.

Mr. Chairman, the question now arises of what is to be done. Let me answer that question by first describing what we have been doing. I have taken very seriously President Reagan's pledge to root out waste, fraud, and abuse in Government. Accordingly, SBA field offices have already instituted corrective action in the cases uncovered in the Ritchey audits performed for the Inspector General.

The audit of the Atlanta district office, to cite just one example, raised questions concerning 53 instances of apparent duplicate payments from other Federal agencies. These 53 cases were reviewed by the district office and duplicate payments were verified in 45 instances. Each of these 45 borrowers was contacted. As of September 1, 18 borrowers had repaid the duplicate portion, 9 had promised repayments, and 18 had not yet responded. Those who have not yet replied will be contacted.

However, this alone is not enough, Mr. Chairman. Loan collecting at SBA has never received the priority accorded loan making. Both are important, and as SBA's part of the administration's efforts to improve Federal debt collection, we have developed a plan which will begin the process of putting these problem farm loans in order.

The most acute need is in region IV, SBA headquarters in Atlanta. Accordingly, I am announcing today the establishment of a new comprehensive loan collection program in region IV. This program will reverse the negative trends and will allow us to achieve full control of the situation at the lowest personnel costs. Let me describe the program to you briefly. It is made up of the following interrelated parts:

First, a single farm-loan-servicing satellite office within the region will be established. Concentrated attention and specialized handling of problems evident in farm credit alone will be addressed exclusively in this closed environment.

Second, a single disaster home loan collection center within the region will also be established. The 17,000 loans in this category will be serviced with the uniform and repetitive routines peculiar to this class of loans. Significant economies of scale will be achieved through the application of specialized attention.

Third, a greatly strengthened overview and supervisory capability in the regional office financial staff will be established.

Fourth, augmentation of the existing permanent staffs of the 10 field offices within the region according to geographic distribution of disaster loans and in direct proportion to existing portfolios and problems will be established.

Fifth, promotion and support for a recently tested collection outreach effort on farm loans will be extended. In a 6-week pilot test in Georgia, intensive communication with delinquent borrowers resulted in collection increases totaling $700,000 per man. In all, 6 temporarily assigned personnel collected over $4 million and reduced delinquent accounts by almost 1,000.

This goes to prove that it is true we have not rated collection as a very high priority. I do not think there is any magic to it, but it has to be a priority. It is no different than any business. Relating it to an accounting service, it is foolish for me to knock my head out and do a lot of accounting services but not get out and collect money for my clients. It is just good business procedure.

Staffs will be allocated from within region IV to manage the farm loan and the disaster home loan facilities. In addition, 99 temporary employees will be brought on board to staff the farm facility, the home loan facility, and the regional and district offices.

We discussed earlier about why we should not be content just focusing on region IV. At SBA, we definitely are not content with just working on region IV. We plan to implement the program. Of course, we will be limited in resources, but it will still be a high priority. However, this will be the project at a meeting next week with the regional administrators.

Hopefully, I will have my new regional adminstrators in the very near future. I will hold them accountable for such a plan.

This principal reason for targeting region IV is there we had a higher percentage of delinquency rate than anywhere else. It was 24 percent. Kansas was 3 percent. Region VI was 11 percent in Texas. Those are the principal farm areas.

Finally, Mr. Chairman, legal questions have been raised about the recovery of duplicate or excess payments by SBA. In many and presumably most cases there will be a contractual relationship between SBA and the borrower that can be used as a basis for collecting these funds in an accelerated manner. However, the audits performed for the SBA Inspector General show that in some cases the loan agreements were incomplete. For example, the borrower may not have agreed that if the loan amount is in excess of what is required to accomplish the purpose of the loan, the excess will be reapplied on the loan. Or the borrower may not have agreed to notify SBA if the total crop yield exceeded the estimated yield so that the amount of the loan can be adjusted accordingly.

The SBA will use every feasible legal method to accelerate the recovery of excess or duplicate funding. I can promise you that we will move quickly within our authority to recover everything that is due the SBA and the U.S. Government. I believe that this is a sound approach to dealing with a difficult problem. Debt collection is going to be given the visibility and support that it has never before received at SBA.

We are considering amendments to our SBA authorities so that we can use private sector institutions that are experienced in servicing and collecting loans.

Finally, Mr. Chairman, I wish to finish by pointing out that we should not allow the basic integrity of the American farmer to be damaged by the actions of a few individuals. I come from a very strong farming community myself. I have found that the American farmer is honest, hard working, and along with other small businessmen, he is the backbone of this country.

I want to thank you for your confidence and kind remarks earlier. It is good to be back after a week's break that I spent with my family. It is good to get back where the action is. Hopefully, we can continue a strong relationship in correcting these problems. With that, I conclude my remarks.

Senator **Weicker**. Thank you very much, Mr. Administrator.

First of all is this business of coordination. This is the second time in the course of hearings before this committee that certain of the SBA programs fall flat on their face because of the lack of coordination. What comes to mind was the lack of coordination on the surety bond program between the Treasury Department and SBA. Now here we have this program where the coordination between Agriculture and SBA fall between the cracks.

Again, this is not something attributed to your administration, but I have to point out to you that invariably SBA programs are intertwined with some other agency of Government and there seems to be a total lack of coordination.

Mr. CARDENAS. I understand that, Senator.

Senator WEICKER. Believe me, it is going to happen again. The history is just replete with that. I think it is something that deserves your attention.

On the business of the loan collection, you heard the testimony yesterday, or I am certain somebody told you about it, not only the facts being placed before the committee by Mr. Boucher, but, in addition, the testimony of Mr. Fahey who was very adament in stating what should be done. His position was based on his feeling that this collection effort should be right across the board. I would like to have your response to that.

Mr. CARDENAS. You mean straight across the board at——

Senator WEICKER. I mean more than region IV.

Mr. CARDENAS. I would have to agree with that. I think our immediate reaction to this was we needed to get it going. It is going to be easier to get just enough to go in IV, but I want to assure you that the same plan that we implement in IV will be implemented in all regions.

We have a meeting next week with our regional administrators, and it will be initiated in all regions. However, we will be limited in resources. Of course, we would like to have the 200-plus to initiate it nationwide, but I assure you that priority will be given even if we have to shift some employees around to implement it.

Senator WEICKER. That is the point I want to make. How many have already been agreed to?

Mr. CARDENAS. Ninety-nine.

Senator WEICKER. There are 99 for region IV. If this requires a little bit of adjustment, that is what the hearing is for. We all came into this hearing talking about region IV. I did, the witnesses did, and everybody did.

Now we have received some very valuable information at the hearing about a potential nationwide problem. It seems to me that if that requires a little redirection of personnel, even out of the 99, to some other areas, let us do it.

Mr. CARDENAS. I agree.

Senator WEICKER. I will give full credit to the ranking member, Senator Nunn. It almost looked as if we were coming down on his head here. Yet he was totally cooperative. In other words, he was the one who backed the committee and the chairman to the hilt on this investigation which by pure happenstance ended up in his backyard. However, it is not his backyard problem. It is all of ours.

I do not know what the situation is in Connecticut. We have a very small agricultural corner up there, but I mean it should go everywhere, Illinois, Connecticut, and not just into Senator Nunn's backyard.

Mr. CARDENAS. That is absolutely correct, Senator. In fact, I had a brief meeting with him yesterday to allude to that.

Senator WEICKER. I have given my advice to OMB on getting additional personnel, but regardless of the situation, I would expect to see an effort made. It might be inadequate because, as you say, the personnel is hard to come by and the money is hard to come by. However, I want to see an effort made in areas other than region IV.

Mr. CARDENAS. Yes. Assuming even if they were the largest amounts, I concur that it would be foolish to just worry about them. We have to worry about everyone. After all, maybe in California they have been a little more fortunate and maybe they have the wherewithal, and whatever needs to be collected there should be collected, too.

Senator WEICKER. What are we going to do about this business of excess crop yields? Are we going to do any more of this guesswork or are we going to wait and see what happens before the money goes out?

Mr. CARDENAS. I feel that we should exercise our utmost authority. We are taking the approach that we can collect it. We should make every effort to collect.

Senator WEICKER. What about waiting to see whether or not a disaster occurs? What is your feeling on that? Maybe Mr. Messick would like to respond.

Mr. MESSICK. Senator, after the 1977 disaster, the agency adopted a policy of waiting until the harvest. For the 1980 disaster, we waited until harvest figures were in to compute the loans. That policy is still in effect.

Senator WEICKER. Mr. Administrator, is that policy in effect nationwide?

Mr. CARDENAS. It should be.

Senator WEICKER. Senator Dixon?

Senator DIXON. Thank you, Mr. Chairman.

Mr. Cardenas, I want to first compliment you on what I consider to be a very positive response to the testimony that has been heard here and on the suggested remedy in the pilot program that you have outlined in your remarks. I appreciate that very much and hope that you will give that the full support of the office, as I know you will. I share the view of the Chair and would include my own great agricultural State of Illinois along with all the others in saying it is a countrywide problem. That is clear from the testimony we have heard here. We are concerned about it.

One of the things that came up that I want to call to your attention, Mr. Cardenas, in a positive way at the hearing yesterday. The Inspector General, who is still in the room, noted that disaster loans had been made without SBA's attorneys reviewing the documents for legal sufficiency.

While I am very much interested in learning how this could have happened, more importantly, I am wondering what steps you have taken or will take in the immediate future to insure that no SBA financial assistance, disaster or otherwise, is made without the legal concurrence of SBA's staff lawyers. May we have your assurance that you will immediately undertake a policy in the office to see that that occurs?

Mr. CARDENAS. Absolutely. By the way, I have my new counsel, Mr. Warren, on board now. I am sure he shares that very view with all of us.

Senator DIXON. Noted by Senator Gorton, and perhaps by all of us from time to time yesterday, was our frustration in continuing to experience in all the testimony that past practices were so bad. You cannot make a fraud case by virtue of the incompetency in the way the thing was handled.

I would certainly hope that we can have the kind of good track record for the future that will make us feel that the matter is being handled in a businesslike way.

Mr. CARDENAS. I have shared that frustration with you over the last 5 months.

Senator WEICKER. To follow up on the point that Senator Dixon made, what effort in the course of your strike force approach is going to apply itself to examining the actions of SBA personnel? We had testimony here yesterday in which there was no question but what Senator Dixon referred to came through loud and clear. There was clearly incompetency on the part of SBA personnel, and I think there was probably fraud involved by SBA personnel as well.

I am just not willing to go roaring after all the farmers and assume that SBA's skirts are clean. They are not. That came across loud and clear, whether it was incompetency or actual intent to defraud. What is going on here in the sense of checking up on SBA personnel?

Mr. CARDENAS. Certainly it is not an easy task. There is a lot of incompetency in my opinion. I have charged all managers, all district directors, and all regional administrators—they will be reminded next week at the meeting—that they are fully accountable for the acts of employees who are conducting themselves in an unbusinesslike manner or any misconduct.

They will also be held responsible if they are not properly documenting people like they should be in their files so that in the event we have to come down hard against them we will have proper documentation to be able to hold it against them.

In the past, there have been many who have been caught in many misconducts and their files have not been documented. Thus, there was nothing that could be done.

There was an example just recently in the State of New York where we had an indictment of an officer. It was a common procedure that you just waited until he was convicted or found innocent before anything was done. I took the immediate act to suspend him without pay until everything was resolved. Recently he was convicted. Of course I took the hard action that he be terminated.

We are going to be looking at them and we are going to keep reminding our administrators and our district directors that they are held accountable for all acts of their employees. I think that until we do that and really stress it, we are not going to cure a lot of those ills that exist.

Senator DIXON. Mr. Chairman, may I pursue that while our distinguished ranking member gets himself together here. He just came into the room.

Senator WEICKER. Certainly.

Senator DIXON. Mr. Cardenas, if I might pursue that a little further, testimony was replete yesterday with evidence that literally hundreds of millions of dollars in these loans were made by temporary employees pressed into service. I can appreciate the circumstances of the disaster and that additional personnel was needed.

However, I would suggest that it is scarcely the businesslike way to run an office, to have temporary employees who know very little about what they are doing making these loans.

It has even been suggested, I think it is fair to state, Mr. Chairman, that some did not even know what they were doing. I think that is a very serious piece of evidence concerning at least past operations of the agency.

I am not going to pursue it today when we are on farm disaster loans, but I come from southern Illinois, Mr. Cardenas, directly across the river from St. Louis. The morning paper that we read where I come from is the St. Louis Globe Democrat. Mr. Tom Amberg, who has recently talked to you, has written a very extensive series on the direct loan program, which I want to ultimately call to your attention. That series is full of statements by people that we have to get this money on the street and so forth.

It really concerns me that there seems to be tremendous evidence here that sound business practices have just not been followed. It is a matter that we would hope can be corrected as quickly and as expeditiously as possible for the future.

Mr. CARDENAS. Senator, I fully concur. As a matter of fact, we have submitted a draft of the proposal for restructuring our approach to the disaster program. Because everybody has had such a busy summer and has also just returned from recess, we have not had much exchange in that direction, but we are intending a complete restructuring of this. We will continue working with staff in the next 2 weeks.

Basically, I concur that bringing in people from another State to work in a disaster area just creates an additional disaster. Our solution to that problem is to identify area managers, four throughout the country, who would be responsible.

It is not that we want to alleviate the regional administrators or the district directors from any responsibility because they still have to be responsible. However, the idea is that when we have a disaster it receive top priority for supervision.

That seems to be the key issue there, proper supervision. If we have responsible managers in those areas and we have a hardcore of our most experienced professional people in SBA working those disasters in those four areas and also going to the other areas as needed, that seems to be an answer.

Also, a new approach in going to the private sector is to identify individuals in their respective communities who will be willing to help at the time there is a disaster. If they are identified in advance, you have people in that community who move right into it. I think it will go a long way in taking care of a lot of these problems.

The fact that we will have better supervision will go a long way also. There is only one minor thing we have to work out in that relation. We would be able to pay them a set rate. Then we have to work out the legality of whether, say, the bank could then pay that banker the difference in his pay rate from what we would pay them.

I firmly believe that, just like providing management assistance in your community, is the only way that a program such as this is going to work effectively. I am going to work very hard to continue that.

By the way, next week when we brainstorm these procedures and lay it out, we will come back to your staff to tell you where we are and how we are progressing on this.

Senator **Dixon**. I want to thank you, Mr. Cardenas, and I want to thank the Chair. I will be glad to yield to my distinguished ranking member.

Senator **Nunn**. Mr. Chairman, I do not have many questions. I have talked with Mr. Cardenas several times on this matter. I do think he is taking a strong step in the right direction in concentrating on debt collection and servicing.

I have also read his statement. I believe he has put the matter in perspective because I know an awful lot of these problems are in the Southeast in region IV. However, as he points out in his statement, I think that is a reflection of the fact that the 1977 drought; which produced most of these loans was followed by two more droughts out of the next 3 years in the Southeast, while other parts of the country did not have that.

I do not think that farmers in the southeastern part of the United States—I know this is true in Georgia—are any less committed to repaying the loans than farmers anywhere else. However, I do believe that they have had 3 out of the last 4 years that have been very, very adverse. That, as Mr. Cardenas points out, is the reason for these percentages.

I also agree that because of the problems and because, I am sure, of more delinquencies in this part of the country, you have to give special attention to the collection there, which you are doing.

Mr. Chairman, in the beginning of this hearing and all the way through it, you have been, I think, eminently fair in pointing that this is a national problem and not a regional problem, and not just a problem involving even disaster loans but rather a broader problem of collection of debt.

I want to thank you, Mr. Chairman, for your consistent total fairness as you approach this matter.

Senator **Weicker**. Senator Nunn, I think the one thing the record has shown is that the problem that exists here has nothing to do with any section of the country. It has to do with the way this program is administered, both in terms of the granting of the loan, in terms of supervision of the loan, and the collection of the loan.

Senator **Nunn**. That is right.

Senator **Weicker**. Quite frankly, if we had a hurricane that hit New England tomorrow and the money was dished out under the conditions that have existed over the past several years, all of these same problems would be in whatever region number the New England region is.

Senator NUNN. I agree. I think it was entirely predictable. I know Mr. Messick and others involved in the program back in 1977 knew at that time that unless they were able to get more people down there—more experienced people in making these loans—that the problems were going to come back to haunt us. Unfortunately, at that time there was not enough expertise available, or it was not made available. I think that was one of the real dilemmas of this program.

You cannot make experts out of temporary employees, particularly in making loans. I think the same thing is true in collecting loans. That is the unfortunate background of this.

I do think that this whole SBA disaster lending program had problems even before the farm situation came up because we have faced it in hurricanes. One of the unfortunate things that happened over and over and over again, with which I believe we are to some extent still plagued today, is the hangover psychological effect of the forgiveness that used to take place on every hurricane that came by. There would always be a very large forgiveness of loans or some portion of the loan.

I think that has had a tendency to make the SBA program viewed by many people as one on which the payback is not to be taken completely seriously. I believe that is something that has to be corrected. We do treat these as loans. Even though they are in my region, I certainly have not favored forgiveness. I do not think that can be done in a fiscally responsible and fair way in this instance or in other instances of disaster.

Let me just ask you a couple of questions, Mr. Cardenas and Mr. Messick, about the loan offices in region IV. How many of them are going to be in the Atlanta district office?

Mr. CARDENAS. I am sorry. How many loans?

Senator NUNN. How many of the new positions are you going to have in the Atlanta district office? First, how many are going to be in region IV and then how many in the Atlanta office?

Mr. CARDENAS. There is a total of 99 that will be added; 16 will be in the district office.

Senator NUNN. How many of the new people are going to be temporary and how many of them are going to be permanent?

Mr. CHAMBERS. Sir, of the 99, 16 for that district, we are talking about temporaries. Of course the permanent staff remains onboard in the district office or in the region. The new people being brought on for the district office specifically would all be temporary.

Senator NUNN. I understand there will be some people leaving the payroll as some come on. What is the net effect?

Mr. CHAMBERS. People who are there now, short of this hearing and short of this effort to see that human resources were directed to this problem, would have gone off the books by September 30. I think the figure right now is 56. Certainly we intend to retain those and bring that up then to a total of 99 in the region.

Senator NUNN. If you could write your own prescription of the number of people you need to properly service the loans that are now on your books in region IV, how many people do you need to do an efficient and effective job?

Mr. Chambers. I would give you one figure and then defer to Wiley since he is there all the time. My estimate initially was 204, which would be an effective number.

Wiley, would you like to comment on that?

Senator Nunn. How many do you have?

Mr. Chambers. As of the end of July, there were 119 in the region in total. That was permanent staff. We had 56 who were temporaries. That is as of July 31.

Senator Nunn. As of July 31, you had an adequate number?

Mr. Chambers. I do not think that is so. If we had 99 temporaries and 119 permanents, I might have been willing to say that that was adequate.

Senator Nunn. I thought you just said you needed 204 altogether.

Mr. Chambers. To do an adequate job over a long period of time, if I had the option of permanent staff to staff each district office and maintain the staffs in each office to do what can be done by each office, that is why I arrived at the figure of 124.

In arriving of a figure of 99, there are efficiencies that can be demonstrated by having a group of people who concentrate only on farm loans. We have a similar operation near Austin, Tex., to do that in Texas. We have at least two other offices in the country that can demonstrate that a small group of people in one place can handle disaster home loans.

Therefore, I can move from 124 down to 99 if I collect people and effectively cause them to concentrate on very specific kinds of loans and very specific kinds of problems. That is how I would come back to the 99 figure.

Senator Nunn. Mr. Messick, do you want to add anything to that?

Mr. Messick. Senator, the financial staff of the region in our presentation for the annual operating plan for fiscal year 1981 had some different figures. I will have to say that this is what the staff feels can adequately handle the whole servicing and liquidation workload. This was based on June 30. At that time, according to our figures, we had 112 portfolio management staff onboard.

Based on agency workload standards that have been used from time to time—I am not sure of the validity of them currently—it was Mr. Scoggins' feeling—and I concurred—that we needed 258 people collecting loans in order to do the optimum job, which would mean that we were 43 percent staffed.

To put this in perspective, when the disaster came, the Atlanta office, the district office, had about $90 million in the portfolio. The region had about $1 billion. After the disaster, we had about $2 billion, with the Atlanta district office having $500 million of that. Now we are up to over $2.5 billion.

Personnel ceilings remained fairly stable. They may be up or down a little, but they were virtually stable over that period of 4 years. We try to do more with fewer people and take shortcuts and find new ways to do things, but it is very difficult.

You did not ask this question, but it is a philosophy I would like to express. I have followed the SBA for something like 23 or 24 years. I started with this committee staff. I watched the agency go from a pretty sound credit agency at the beginning of that time with a lot of the RFC traditions. RFC may have made some bad loans, but it was pretty good at collecting.

I watched the agency go to softer credit and less concern with collections. It did it in an almost unbroken line from administration to administration. You cannot say A did it or B did it or C did it, but it did happen.

SBA employees over past administrations have received brownie points for making loans. Collecting loans has been secondary. I think that Mr. Cardenas' focus on collections, and the President's focus on collections, is one of the things that can reestablish the integrity and credibility of the SBA.

Since I have given most of my public service to the cause of small business, I am very much interested in seeing that happen because I believe in the small business cause. I would like to see the agency that is serving that cause reestablish its credibility with the American taxpayers.

Senator NUNN. Do you not think if collection is emphasized more, it will also have an indirect effect of making the loans sounder in the future?

Mr. MESSICK. Yes, sir.

Senator NUNN. That people will pay more attention to the security and soundness of the loan?

Mr. MESSICK. Yes, sir.

Senator NUNN. Back in 1977 or early 1978 when the disaster program was getting off the ground and you were, I know, being absolutely swamped with loan applications, did you at that time request more staff from the SBA central office?

Mr. MESSICK. Yes, sir, we requested staff. Senator, we got a lot of people before it was over. Sometimes we did not get them soon enough, but we had 50 people or from Farmers Home Administration. At one point, we had as many as 240 people working in the Georgia office alone.

We had more people, with a roughly equivalent number of permanents and temporaries around the region. In other words, we were running around 450 to 470 in permanent employees and the maximum number of temporary employees was 459 at any one time.

However, that was not enough people to move the applications along expeditiously, to close them expeditiously, and to do everything in a timely manner. The farmers were getting ready to plant the new crops and did not have the receipts from the last year's disaster.

Senator NUNN. What is the maturity date on most of these loans? Let us say the median maturity date on these disaster loans made in 1977-78.

Mr. MESSICK. That would be a guess on my part. They ranged from less than 10 to 30 years. I would guess the median would be 15 or 20 years.

Senator NUNN. How long are you going to have to have intensive efforts to service these loans?

Mr. MESSICK. Senator, if we could have 2 or 3 years of good rainfall—we look at rainfall as collateral, and it is about all we have as collateral in some cases—and if we could get 2 or 3 good crop years, I think that servicing of these loans would become routine.

Now, they are requiring intensive servicing. The district director in Columbia has indicated that in his portfolio there is an average of six point something servicing actions per case per year. That would be requests for subordination or a change of collateral or whatever.

The typical business loan requires about five servicing actions. However, most of the business loans are serviced by the banks. The farm disaster loans requires more intensive servicing than the loans that we delegate to the banks to service. It is a heavy workload.

Senator NUNN. Do you believe this new infusion of personnel is going to be able to suffice? Do you think you are going to be able to do the job with these people?

Mr. MESSICK. Senator, it will increase our credibility substantially if we concentrate on the two servicing divisions, home and farm loans. It will leverage the effectiveness of the employees. Maybe not as much as the number we requested, but this will be a big help.

We are faced with reopening the loans that were pending at the time of the rules change and we will need temporary staffing to take care of that in addition to these people. Those loans will have to be addressed. We have notified the districts of the new rules and they started yesterday with the business of notifying each farmer who was affected by the rules change.

Senator NUNN. Do you have any breakdown of how many of these loans you made without any security relating to land?

Mr. MESSICK. No, sir.

Senator NUNN. Is that figure somewhere available? I do not want a massive study to determine it, but I think it would be some indication of adequacy of collateral if we knew how many of them were based strictly on equipment or livestock as opposed to land.

Mr. MESSICK. Senator, we took the best collateral available. A disaster loan requires repayability. Some loan officer and supervisor must see repayability in an application to approve it. The repayability should be there, but the agency has not looked to collateral primarily for making disaster loans, farm or otherwise.

Senator NUNN. If those figures are available without having a massive study—I do not want to add to your burdens—if there is information you could break out showing the number of your farm disaster loans nationwide that are secured—I do not care whether it is a first, second, third, or fourth mortgage—with land, then I would like that.

Mr. HERTZBERG. Senator, we could probably get a rough estimate or a feeling for some percentage that were secured in various ways, but to come up with an accurate figure would be extremely difficult.

Senator NUNN. Could you give me your best estimate then? If that best estimate is going to require a lot of man-hours, I wish you would let the staff know and I will retract my request. I do not want to add to your burden right now, but I do think if you can make an estimate on that, it would give us some idea.

Mr. HERTZBERG. Our difficulty would be that that is not tracked in the computer. Other than an estimate by those experienced and who were exposed to the cases, it would have to be done by examining files. It would make it very difficult.

Senator NUNN. Do not do it if it is going to require a lot of manhours. That is not a priority item, but just let the staff know on that what it would require.

Mr. HERTZBERG. Yes, sir.

Senator NUNN. Even just a rough ballpark estimate with all sorts of caveats would be a help. I would like to know whether 50 or 75 or 25 percent are secured. Obviously, equipment collateral is not very secure as the years go by.

Mr. HERTZBERG. I believe we could do that without too much difficulty.

[Subsequent information was received and follows:]

Approximately 95 percent of loans approved are secured by some degree of lien on land.

Senator NUNN. Mr. Messick, when you have your loan officers out there, are they coordinating with Production Credit Associations where you are secondary to them or are making loans in connection with them?

Mr. MESSICK. Not initially. It has come up repeatedly since the first loan because PCA is frequently requesting subordination for the next year's crop. We do touch base with them or they touch base with us. That is the way quite a few of these loans have been kept current. SBA subordinates to the crop loan. The collateralized loan subordinates to the crop loan. PCA makes the payment that year.

In my opinion, there is not day-to-day touch with PCA on a statewide basis. They are organized usually a few counties at a time. I would guess that we have no coordination statewide.

Senator NUNN. It seems to me in these delinquent cases that you would be well advised to have your loan officials at least touch base on the telephone where PCA is involved because they know more about the particular individual's farming situation than anybody, including sometimes the individual.

The way they make the loan usually is they advance money on a day-by-day basis. If they make a commitment for $100,000, that is not all drawn at one time like a normal bank loan. It is usually drawn as needed. All the cash receipts from crops and everything that sells goes back to them. It is a revolving type loan.

I think it would be of great help if you could get some agreement at the national level and carry that down to the working level to get PCA's to sit down with your people or at least have telephone conferences about these delinquencies as to what they project.

I know SBA does not want to end up in the farming business and foreclosing and owning a lot of equipment and cattle. In some cases, you may have to, but where you can work with the PCA's would be of great benefit to you and your collection, I think.

Also, I think as time goes by and they have some successful years, which hopefully will come, you can begin to shift more and more of the disaster loans to PCA's and let them refinance.

Mr. CHAMBERS. Senator, I would like to add with regard to the State of Georgia between roughly the 1st of April and the end of

August they had about 9,400 farm loans in Georgia. Approximately 7,100 of those loans involved the effort that goes into a subordination. The bulk of those were subordinations to a PCA so that the PCA could make a crop loan for next year. In the deal, PCA also makes sufficient loan so that the farmer can then come and pay us last year's payment. We become current on the loan, PCA makes next year's crop loan, and we are off until next year.

This problem is the same sort of problem that comes up each year with subordinations. It is widely said if you have 2 or 3 years of good rainfall, you cure an awful lot of those problems.

Senator NUNN. Do any of you know how many bankruptcies there were in Georgia in farming last year, or do you have any information about how many foreclosures you made in region IV? How many foreclosures have you made on these SBA disaster loans?

Mr. MESSICK. Senator, most of the limited recoveries have come from third parties that have caused foreclosures and where SBA has been in a second, third, or fourth mortgage position. To the best of my knowledge, we have not initiated a farm foreclosure yet in Georgia.

Senator NUNN. Could you furnish those figures on a regional basis, and could you furnish the figures on how many SBA initiated foreclosures there have been in Georgia and on a national basis?

Mr. MESSICK. Yes, sir.

[Subsequent information was received and follows:]

As of July 31, 1981, there were nationally 622 disaster farm loans charged off for $14.8 million. Total dollar amount of loans approved was $16.2 million.

As of October 6, 1981, SBA had initiated foreclosures on 52 disaster farm loans in Region IV. Originally balance owing to SBA was $3,879,110, of which $2,651,370 was recovered.

Mr. MESSICK. There have been some cases where there have been deaths and estates have been settled and that sort of thing, but as to a straight foreclosure, I am doubtful that we have initiated one, but I will find out in our region.

Senator NUNN. Do you have an opinion, Mr. Messick, about what would have happened if SBA had not been involved in region IV?

Mr. MESSICK. Yes, sir, I do. I come from a farming community and I know what happened in 1977 and again in 1981. As a matter of fact, in my home part of Alabama, the main money crop, peanuts, the harvest was the least in history. It was 200 pounds an acre, sometimes not harvested at all, as compared with a good yield of maybe 3,700 to 4,000 an acre.

It was devastating. I think much of the land would have already changed hands. Some is changing gradually through bank foreclosures. More agribusinesses than have gone down would have fallen apart: Farm implement dealers, seed and fertilizer dealers, people who buy and sell crops, and some banks.

I had more than one banker tell me that his bank would have been in deep trouble without the program. I had several bankers say they knew of other banks that could not have made it through without the program. I suppose the PCA's would have had some extreme difficulties for its member-owners. Some of the individual PCA's might not have survived.

I think it was necessary. I wish Agriculture could have handled it for us. It is an experience I would not want to wish on anybody, but it is an experience of a lifetime that I will never forget.

Senator **Nunn**. On April 29, you sent a memorandum to the central office, Mr. Messick, discussing personnel reductions in your region. You stated in the memorandum that if you do not receive more personnel to service the loan portfolio, "then we are surely going to see a $2.5 billion portfolio of loans in this region deteriorate further due to lack of personnel resources."

Two questions: One, do you believe that you now have at least the kind of personnel commitment that you need to not have this situation take place?

Mr. **Messick**. Senator, I am much, much happier to have 99 people, and so will be the new regional administrator, to go forward to collect these funds rather than be in the position we were in. I believe we can make strong progress toward bringing down the delinquencies and establishing credibility.

Senator **Nunn**. The second question: How would you categorize the seriousness of the problems in your region's portfolio of disaster loans?

Mr. **Messick**. It is the worst we have ever had. After last year's harvest, the delinquency rate was the worst it has ever been on farm disaster and for the overall portfolio. We had always prided ourselves on having the most current portfolio of any of the large regions, but we lost that with the farm disasters. We are in bad shape compared to the other regions. We have a lot of work to do.

Senator **Nunn**. Thank you very much, Mr. Chairman.

Senator **Weicker**. Thank you very much, Mr. Administrator, Mr. Messick, and all the others.

[The prepared statement of Mr. Cardenas follows.]

STATEMENT OF
MICHAEL CARDENAS, ADMINISTRATOR
U. S. SMALL BUSINESS ADMINISTRATION
BEFORE THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

SEPTEMBER 10, 1981

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, IT IS A PLEASURE TO APPEAR BEFORE YOU THIS MORNING. I SHOULD LIKE TO DISCUSS WITH YOU THE SMALL BUSINESS ADMINISTRATION'S NEW PROGRAM TO BRING UNDER CONTROL THE VARIOUS PROBLEMS IN AGRICULTURAL DISASTER LENDING THAT PREVIOUS WITNESSES HAVE DESCRIBED. BUT FIRST, SO THAT THE HEARING RECORD WILL BE COMPLETE, I SHALL BRIEFLY SKETCH THE HISTORY OF SBA'S INVOLVEMENT IN FARM DISASTER LOANS.

HISTORY OF SBA INVOLVEMENT IN AGRICULTURAL DISASTER LENDING

PRIOR TO 1976, THE SMALL BUSINESS ACT DID NOT PERMIT ANY LOANS TO AGRICULTURAL ENTERPRISES. IN THAT YEAR THE ACT WAS AMENDED TO PERMIT SBA TO MAKE AGRICULTURAL LOANS. EVEN AFTER THE STATUTORY CHANGE, SBA DID NOT MAKE AGRICULTURAL DISASTER LOANS BECAUSE THE DEPARTMENT OF AGRICULTURE HAD THE PROGRAMS, THE BUDGET, AND THE EXPERTISE.

SBA BELIEVED THAT IT WOULD BE BETTER FOR THE FARMERS AND MORE COST-EFFECTIVE FOR THE GOVERNMENT IF THE DEPARTMENT OF AGRICULTURE CARRIED OUT THESE FUNCTIONS.

IN THE SPRING OF 1977, WHEN THE EXTENT OF THE DROUGHT IN THE SOUTH AND MID-WEST BECAME APPARENT, SBA -- UNDER INTENSE PRESSURE -- OPENED THE DISASTER LOAN PROGRAM TO FARMERS. IT WAS IN THIS SETTING, AND WITH NO PRIOR EXPERIENCE, THAT SBA BEGAN ITS DISASTER FARM LENDING PROGRAM.

THERE WAS MUCH FOR THE AGENCY TO LEARN, BUT LITTLE TIME IN WHICH TO LEARN IT, SINCE THE PROGRAM CAME INTO BEING IN THE MIDST OF A SERIOUS DROUGHT. ALL THE WHILE THAT SBA WAS DEVELOPING THE PROGRAM, THERE WAS INTENSE PRESSURE TO GET THE MONEY FLOWING. AND THIS THE AGENCY DID. THE PROGRAM LEVEL INCREASED TEN-FOLD, FROM ABOUT $200 MILLION A YEAR TO OVER $2 BILLION A YEAR.

MY REMARKS SHOULD IN NO WAY BE CONSTRUED AS AN EXCUSE OR A JUSTIFICATION FOR ANY ERRORS OR ANY WRONGDOING THAT OCCURRED IN THE IMPLEMENTATION OF THIS PROGRAM. AND THERE IS NO DOUBT THAT MANY ERRORS WERE MADE. THE SBA AUDIT REPORTS AND THE COMMITTEE

STAFF FINDINGS HAVE DETAILED AREAS WHERE EXCESS PAYMENTS AND DUPLICATE LOANS MAY HAVE BEEN MADE. THE EXCESSES DETAILED BY THE VARIOUS REPORTS LARGELY REFER TO MATTERS THAT TOOK PLACE EARLY IN THE PROGRAM'S EXISTENCE. THEY INVOLVE MAINLY LOANS MADE IN CONNECTION WITH THE WIDESPREAD 1977 DROUGHT DISASTER.

SINCE THAT TIME SBA HAS MADE MANY CHANGES TO CORRECT VARIOUS PROBLEMS. AS SBA HAS GAINED EXPERIENCE, ITS REGULATIONS HAVE BEEN CHANGED TO REFLECT THE AGENCY'S UNDERSTANDING OF THE ECONOMICS OF FARMING. PARTICULARLY, SBA HAS CHANGED ITS METHODS FOR IDENTIFYING THE AMOUNT OF LOSSES, SETTING TERMS FOR DISBURSEMENT, DRAWING LOAN TERMS AND CONDITIONS AND ENSURING THAT DUPLICATE ASSISTANCE IS NOT FORTHCOMING. FINALLY, PUBLIC LAW 96-302, HAS PUT THE RESPONSIBILITY FOR PROVIDING FARM DISASTER ASSISTANCE BACK IN THE DEPARTMENT OF AGRICULTURE, WHERE IT BELONGS.

CURRENT STATUS OF PORTFOLIO

LET ME NOW TURN TO THE CURRENT STATUS OF THE FARM LOAN PORTFOLIO. AS OF JULY 31, 1981, THERE WERE 74,891 FARM LOANS ON OUR BOOKS. RECOGNIZING THAT THESE LOANS CALL FOR ONCE-A-YEAR

ANNUAL PAYMENTS. IT IS SIGNIFICANT TO POINT OUT THAT OVER 87% OF THOSE LOANS ARE PAID TO DATE AND ARE CONSIDERED CURRENT. GEOGRAPHICALLY THE MAJORITY OF THESE LOANS ARE IN THE MIDWEST, THE SOUTHWEST, AND THE SOUTHEAST, AS MIGHT BE EXPECTED. THESE ARE THE PARTS OF THE COUNTRY WHICH HAVE SUSTAINED VARYING DEGREES OF SEVERE WEATHER PROBLEMS DURING THE PAST FIVE YEARS. 97% OF KANSAS CITY'S 20,883 LOANS ARE CURRENT, WHILE 89% OF THE DALLAS REGION'S 20,682 LOANS ARE PAID TO DATE. THE ATLANTA REGION, WHICH CONTAINS 8 SOUTHEASTERN STATES AND WHICH HAS BEEN VICTIMIZED MORE HEAVILY BY ADVERSE WEATHER PROBLEMS IN THE FIVE-YEAR PERIOD, HAS 23,874 LOANS AND A CURRENT RATE OF 76%. THIS, INCIDENTALLY, IS AN IMPROVEMENT OVER JUNE 30TH FIGURES WHICH STOOD AT 74%.

THE TROUBLED PORTION OF THE TOTAL FARM LOAN PORTFOLIO, THE OTHER 13%, MAY BE DIVIDED INTO THREE PARTS. THE FIRST IS THAT GROUP UPON WHICH WE HAVE MADE CONSCIOUS CREDIT DECISIONS TO DEFER THIS YEAR'S PAYMENT UNTIL AFTER HARVEST TIME THIS FALL. THIS REPRESENTS 6.28% OF THE NUMBERS. THE NEXT GROUP, 4.61% OF THE TOTAL, ARE THOSE ON WHICH SERVICING ACTIONS AND FACE TO FACE DECISIONS HAVE NOT BEEN FINALIZED AND THAT ARE AT LEAST SIXTY DAYS PAST DUE. IN ACTUAL NUMBERS, THE FIGURE IS 3,455 OF WHICH 2,272 ARE IN THE SOUTHEAST. THE FINAL CATEGORY, LESS THAN 1%, ARE CLASSIFIED AS LIQUIDATION CASES. WHILE SBA'S EFFORTS ARE PRIMARILY DIRECTED AT SAVING EVERY POSSIBLE LOAN SO THAT IT MAY ULTIMATELY PAY OUT, MOST LIQUIDATION CASES RESULT BY VIRTUE OF OTHER LENDERS AHEAD OF SBA IN LIEN POSITIONS INSTITUTING FORECLOSURE ACTIONS OVER WHICH WE HAVE LITTLE CONTROL. AFTER FIVE YEARS AND OVER $3 BILLION IN DISBURSED LOANS, WE HAVE SUSTAINED $14.8 MILLION IN CHARGED OFF LOSSES. THIS VERY LOW LOSS RATE SHOULD NOT, HOWEVER, MASK THE FACT THAT WITHOUT A CONCERTED EFFORT TO PROVIDE ADDITIONAL HUMAN RESOURCES TO ADDRESS CRITICAL CURRENT PROBLEMS, SUCH AS THOSE IN THE SOUTHEAST, THE PORTFOLIO PROBLEMS CAN MAGNIFY VERY RAPIDLY.

THE SERVICING, COLLECTION AND LIQUIDATION ACTIVITIES RELATED TO FARM LOAN, REGULAR BUSINESS LOAN, AND THE EXTENSIVE DISASTER HOME LOAN PORTFOLIOS ARE HANDLED BY THE SAME STAFFS. AS EACH YEAR PASSED, THE SIZE OF THE PORTFOLIO TO BE MAINTAINED HAS INCREASED. RELATIVELY SPEAKING, THE MIDWEST HAS PRESENTED THE FEWEST PROBLEMS, WHICH WE CAN ATTRIBUTE TO GENERALLY BETTER WEATHER CONDITIONS. THIS SEGMENT OF THE FARM PORTFOLIO DEMONSTRATES, IN OUR OPINION, THAT FARMERS, LIKE OTHER BORROWERS, DO PAY WHEN THEY HAVE HAD A SUCCESSFUL SEASON.

ON THE OTHER HAND, THE SOUTHEAST, HAVING HAD WORSE LUCK WITH THE WEATHER, REFLECTS A CONDITION IN WHICH FARMER-BORROWERS WANT TO MEET THEIR OBLIGATION BUT ARE HAVING DIFFICULTIES. THIS SET OF CIRCUMSTANCES TRIGGERS THE CASE BY CASE PROBLEM SOLVING DIFFICULTIES REQUIRING THAT REASONABLE SOLUTIONS BE WORKED OUT. BECAUSE OF THE GENERAL NATURE OF THE FINANCIAL CYCLE IN FARMING OPERATIONS, THE PROBLEMS COME IN WAVES. OUR EFFORTS TO MEET THESE ONSLAUGHTS FILL THE CALENDAR FROM FEBRUARY THROUGH AUGUST WITH THOUSANDS OF INDIVIDUAL DECISIONS TO SUBORDINATE, TO DEFER, TO MOUNT COLLECTION "OUTREACH" PROJECTS AND TO CAREFULLY DECIDE WHICH CASES HAVE REACHED THE END OF THE LINE. PROFESSIONALLY TRAINED LOAN OFFICERS WITH COUNSEL AND ASSISTANCE FROM OUR LAWYERS PLUS A FEW CLERK-TYPISTS COMBINE THEIR TIME AND TALENTS TO ACHIEVE THE NECESSARY RESULTS. WE HAVE LEARNED FROM EXPERIENCE AND WE HAVE IMPROVED OUR ABILITIES TO RECOGNIZE AND REACT TO THE DEMANDS OF COLLECTIONS AND DELINQUENCIES.

COMPREHENSIVE LOAN COLLECTION PROGRAM

MR. CHAIRMAN, THE QUESTION NOW ARISES, WHAT IS TO BE DONE. LET ME ANSWER THAT QUESTION BY FIRST DESCRIBING WHAT WE HAVE BEEN DOING. I TAKE VERY SERIOUSLY PRESIDENT REAGAN'S PLEDGE TO ROOT

OUT WASTE, FRAUD AND ABUSE IN GOVERNMENT. ACCORDINGLY, SBA FIELD OFFICES HAVE ALREADY INSTITUTED CORRECTIVE ACTION IN THE CASES UNCOVERED IN THE RICHEY AUDITS PERFORMED FOR THE INSPECTOR GENERAL. THE AUDIT OF THE ATLANTA DISTRICT OFFICE, TO CITE JUST ONE EXAMPLE, RAISED QUESTIONS CONCERNING 53 INSTANCES OF APPARENT DUPLICATE PAYMENTS FROM OTHER FEDERAL AGENCIES. THESE 53 CASES WERE REVIEWED BY THE DISTRICT OFFICE AND DUPLICATE PAYMENTS WERE VERIFIED IN 45 INSTANCES. EACH OF THESE 45 BORROWERS WAS CONTACTED. AS OF SEPTEMBER 1, 18 BORROWERS HAD REPAID THE DUPLICATE PORTION, 9 HAD PROMISED REPAYMENTS, AND 18 HAD NOT YET RESPONDED. THOSE WHO HAVE NOT YET REPLIED WILL BE CONTACTED.

BUT THIS ALONE IS NOT ENOUGH, MR. CHAIRMAN. LOAN COLLECTING AT SBA HAS NEVER RECEIVED THE PRIORITY ACCORDED LOAN MAKING. BOTH ARE IMPORTANT, AND AS SBA'S PART OF THIS ADMINISTRATION'S EFFORTS TO IMPROVE FEDERAL DEBT COLLECTION, WE HAVE DEVELOPED A PLAN WHICH WILL BEGIN THE PROCESS OF PUTTING THESE PROBLEM FARM LOANS IN ORDER.

THE MOST ACUTE NEED IS IN REGION IV, SBA HEADQUARTERS IN ATLANTA. ACCORDINGLY, I AM ANNOUNCING TODAY THE ESTABLISHMENT OF A NEW COMPREHENSIVE LOAN COLLECTION PROGRAM IN REGION IV.

THIS PROGRAM WILL REVERSE THE NEGATIVE TRENDS AND ALLOW US TO ACHIEVE FULL CONTROL OF THE SITUATION AT THE LOWEST PERSONNEL COSTS. LET ME DESCRIBE THE PROGRAM TO YOU. IT IS MADE UP OF THE FOLLOWING INTERRELATED PARTS:

- A SINGLE FARM LOAN SERVICING SATELLITE OFFICE WITHIN THE REGION. CONCENTRATED ATTENTION AND SPECIALIZED HANDLING OF PROBLEMS EVIDENT IN FARM CREDIT ALONE WILL BE ADDRESSED EXCLUSIVELY IN THIS CLOSED ENVIRONMENT.

- A SINGLE DISASTER HOME LOAN COLLECTION CENTER WITHIN THE REGION. THE 17,000 LOANS IN THIS CATEGORY WILL BE SERVICED WITH THE UNIFORM AND REPETITIVE ROUTINES PECULIAR TO THIS CLASS OF LOANS. SIGNIFICANT ECONOMIES OF SCALE WILL BE ACHIEVED THROUGH THE APPLICATION OF SPECIALIZED ATTENTION.

- A GREATLY STRENGTHENED OVERVIEW AND SUPERVISORY CAPABILITY IN THE REGIONAL OFFICE FINANCIAL STAFF.

- AUGMENTATION OF THE EXISTING PERMANENT STAFFS OF THE TEN FIELD OFFICES WITHIN THE REGION ACCORDING TO GEOGRAPHIC DISTRIBUTION OF DISASTER LOANS, AND IN DIRECT PROPORTION TO EXISTING PORTFOLIO PROBLEMS; AND --

- PROMOTION AND SUPPORT FOR A RECENTLY TESTED "COLLECTION OUTREACH" EFFORT ON FARM LOANS. IN A SIX WEEK PILOT TEST IN GEORGIA, INTENSIVE COMMUNICATION WITH DELINQUENT BORROWERS RESULTED IN COLLECTION INCREASES TOTALLING $700,000 PER MAN. IN ALL, SIX TEMPORARILY ASSIGNED PERSONNEL COLLECTED OVER $4 MILLION AND REDUCED DELINQUENT ACCOUNTS BY ALMOST 1,000.

STAFFS WILL BE ALLOCATED FROM WITHIN REGION IV TO MANAGE THE FARM LOAN AND THE DISASTER HOME LOAN FACILITIES. IN ADDITION, 99 TEMPORARY EMPLOYEES WILL BE BROUGHT ON BOARD TO STAFF THE FARM FACILITY, THE HOME LOAN FACILITY, THE REGIONAL OFFICE AND THE DISTRICT OFFICES.

FINALLY, MR. CHAIRMAN, LEGAL QUESTIONS HAVE BEEN RAISED ABOUT THE RECOVERY OF DUPLICATE OR EXCESS PAYMENTS BY SBA. IN MANY AND PRESUMABLY MOST CASES THERE WILL BE A CONTRACTUAL RELATIONSHIP BETWEEN SBA AND THE BORROWER THAT CAN BE USED AS A BASIS FOR COLLECTING THESE FUNDS IN AN ACCELERATED MANNER. HOWEVER, THE AUDITS PERFORMED FOR THE SBA INSPECTOR GENERAL SHOW THAT IN SOME CASES THE LOAN AGREEMENTS WERE INCOMPLETE. FOR EXAMPLE, THE BORROWER MAY NOT HAVE AGREED THAT IF THE LOAN AMOUNT IS IN EXCESS OF WHAT IS REQUIRED TO ACCOMPLISH THE PURPOSE OF THE LOAN, THE EXCESS WILL BE REAPPLIED ON THE LOAN.

OR THE BORROWER MAY NOT HAVE AGREED TO NOTIFY SBA IF THE TOTAL CROP YIELD EXCEEDED THE ESTIMATED YIELD SO THAT THE AMOUNT OF THE LOAN CAN BE ADJUSTED ACCORDINGLY.

THE SMALL BUSINESS ADMINISTRATION WILL USE EVERY FEASIBLE LEGAL METHOD TO ACCELERATE THE RECOVERY OF EXCESS OR DUPLICATE FUNDING. I CAN PROMISE YOU THAT WE WILL MOVE QUICKLY WITHIN OUR AUTHORITY TO RECOVER EVERYTHING THAT IS DUE TO THE SBA. I BELIEVE THAT THIS IS A SOUND APPROACH TO DEALING WITH A DIFFICULT PROBLEM. DEBT COLLECTION IS GOING TO BE GIVEN THE VISIBILITY AND SUPPORT THAT IT HAS NEVER BEFORE RECEIVED AT SBA.

WE ARE CONSIDERING AMENDMENTS TO SBA AUTHORITIES SO THAT WE CAN USE PRIVATE SECTOR INSTITUTIONS THAT ARE EXPERIENCED IN SERVICING AND COLLECTING LOANS.

AND FINALLY, MR. CHAIRMAN, I WISH TO FINISH BY POINTING OUT THAT WE SHOULD NOT ALLOW THE BASIC INTEGRITY OF THE AMERICAN FARMER TO BE DAMAGED BY THE ACTIONS OF A FEW INDIVIDUALS. THE AMERICAN FARMER IS HONEST, HARD-WORKING AND ALONG WITH OTHER SMALL BUSINESSMEN IS THE BACKBONE OF THIS COUNTRY.

MR CHAIRMAN, THIS CONCLUDES MY PREPARED REMARKS. I WOULD BE PLEASED TO ANSWER ANY QUESTIONS YOU MAY HAVE.

Senator **Nunn**. Mr. Chairman, before you adjourn, let me just again repeat how much I personally appreciate the fairness with which you have proceeded on this problem. It is not one involving your home area. Yet you have shown great sensitivity to treating it on a national basis in total fairness. Your staff has done likewise. Our staffs have worked together. I want to thank both you and your staff for bringing these problems to the forefront. I believe that these hearings are going to serve as a foundation from which great improvement can be made in this program, not just with what has already happened but what will happen in the future. I commend you.

Senator **Weicker**. Thank you very much.

With that, these hearings will be adjourned.

[Whereupon, at 11:25, the committee adjourned, to reconvene at the call of the chair.]